Trust Modification: Non-Judicial Settlement Agreements, Decanting, and Disclaimers

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INTRODUCTION

Irrevocable Trusts are often rigid and inflexible documents. One of the purposes of having a trust document that is irrevocable and unamendable is to prevent changes to the document and impose provisions on the trust's beneficiaries, regardless of whether the beneficiaries are happy with those provisions or not. However, it is not unusual that changes need to be made to an irrevocable trust document. Despite drafter's best efforts, errors are made that frustrate the purposes that the trust was originally intended to accomplish. Trust provisions may become outdated or unneeded due to the passage of time. Beneficiaries may desire to change a trusts provisions. While drafters can and should attempt to create as much flexibility in irrevocable trusts as possible, many provisions of an estate planning document by nature are not changeable by the terms of that document.

The law of trusts has always recognized that the terms of an irrevocable trust document may be modified by a court or the beneficiaries under certain conditions, Restatement Third, Trusts, Part 5. Common law of trusts provides that a trust may be rescinded or reformed on the grounds of fraud, duress, undue influence, or mistake, Restatement Third, Trusts § 62. A trust may be modified or terminated on consent of all beneficiaries, unless that action would be inconsistent with a material purpose of the trust, Restatement Third, Trusts, § 65. A trust may be modified or terminated on consent of all beneficiaries and the settlor, regardless of whether that action would be inconsistent with a material purpose of the trust, Restatement Third, Trusts, § 65. A court may modify a trust because of unanticipated circumstances, Restatement Third, Trusts, § 66. A Charitable Trust may be reformed by a court if the charitable purpose of that trust has become unlawful, impossible, or impractical to carry out, Restatement Third, Trusts, § 67. A trust may be divided or merged, so long as such action does not affect the right of any beneficiary.

Trust law regarding modification and termination outside the terms of a trust have become more liberal over the years. The Third Restatement of trusts notes that those rules have been liberalized because of "…(i) modern trends in legislative policy and judicial decisions and (ii) practical considerations arising from other developments in or affecting estate planning," Restatement Third, Trusts, Introductory note to Part 5. Prior to the enactment of the Uniform Trust Code in many jurisdictions, changes to irrevocable trust document almost always required court proceedings, if only for the purpose of invoking the doctrine of virtual representation and appointing representatives for beneficiaries or classes of beneficiaries that could not otherwise be bound be an agreement changing the terms of a trust. Disclaimers and releases have also been available for changing trust beneficiaries under certain circumstances. In the past decades two other tools have become more widely available to estate planning attorneys, decanting and non-judicial settlement agreements. This outline is intended to discuss the requirements of these three mechanism for changing trust instruments and their respective pluses and minuses.

This outline is an attempt to discuss the practical aspects of these methods of modifying trust interests. There are many other sources which discusses the transfer tax implication of these methods, and this outline does not include a great deal of such discussions. However, this is not true of the disclaimers section which is a reprint of an outline from 1999 and which the author deemed would be a shame to delete all of the tax portions. This does not mean that there cannot be serious tax implications of a change to an irrevocable trust agreement. Changing beneficial interest in a trust by any means can result in serious federal transfer tax consequences, such as taxable gifts, inclusion of assets in a settlor's taxable estate, inclusion of assets in a beneficiary's estate, or making assets otherwise exempt from generation skipping transfer tax subject to such tax.

The author is a Missouri attorney and thus Missouri law is highlighted. Attempt have been made to also include some aspects of the applicable laws Oklahoma, Arkansas, Kansas, Nebraska and Iowa, but it should not be taken as an exhaustive treatise on the laws of those states. It is helpful that all of those states, except Oklahoma have some version of the Uniform Trust Code (UTC), though Iowa actually adopted a draft of the UTC prior to it being finalize by the Uniform Law Commissioners and is not considered a UTC state.

NON-JUDICIAL SETTLEMENT AGREEMENTS

UTC Provisions.

The UTC contains § 111 which specifically authorizes Non-Judicial Settlement Agreements (NJSA).[1]

SECTION 111. NONJUDICIAL SETTLEMENT AGREEMENTS.

> (a) For purposes of this section, "interested persons" means persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by the court.
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> (b) Except as otherwise provided in subsection (c), interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust.
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> (c) A nonjudicial settlement agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under this [Code] or other applicable law.
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> (d) Matters that may be resolved by a nonjudicial settlement agreement include:
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> (1) the interpretation or construction of the terms of the trust;
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> (2) the approval of a trustee's report or accounting;
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> (3) direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power;

[1] Kansas significantly altered its version of UTC Section 111, K.S.A. 58a-111, to provide that only the following matters can be resolved by a NJSA: approval of Trustee's reports or accountings, the resignation or appointment of a trustee and the determination of a trustee's compensation, transfer of a trust's principal place of administration, and liability of a trustee for an action relating to the trust.

(4) the resignation or appointment of a trustee and the determination of a trustee's compensation;

(5) transfer of a trust's principal place of administration; and

(6) liability of a trustee for an action relating to the trust.

(e) Any interested person may request the court to approve a nonjudicial settlement agreement, to determine whether the representation as provided in [Article] 3 was adequate, and to determine whether the agreement contains terms and conditions the court could have properly approved.

While NJSAs were certainly not prohibited by the common law of trusts prior to the enactment of the UTC, it was always very difficult to have all persons affected by a settlement agreement (e.g the trust beneficiaries) to agree to any modification or termination unless there were not minors, unborn, or unascertainable beneficiaries of the trust. It is unusual for a trust to not have open classes of beneficiaries, such as "descendants" or "heirs," who cannot personally sign off on an agreement. Probably more importantly than Section 111, the UTC contains detailed representation rules for trusts that apply both in the judicial context and outside judicial proceedings that really makes NJSAs workable.

SECTION 301. REPRESENTATION: BASIC EFFECT.

(a) Notice to a person who may represent and bind another person under this [article] has the same effect as if notice were given directly to the other person.

(b) The consent of a person who may represent and bind another person under this [article] is binding on the person represented unless the person represented objects to the representation before the consent would otherwise have become effective.

(c) Except as otherwise provided in Sections [411 and] 602, a person who under this [article] may represent a settlor who lacks capacity may receive notice and give a binding consent on the settlor's behalf.

[(d) A settlor may not represent and bind a beneficiary under this [article] with respect to the termination or modification of a trust under Section 411(a).]

The rest of UTC Article Three contains a series of specific representation rules; Section 302 "Representation by Holder of General Testamentary Power of Appointment," Section 303 "Representation by Fiduciaries and Parents," and Section 304 "Representation by Person Having Substantially Identical Interest." In the UTC a person cannot represent another person if there is a conflict of interest.

SECTION 302. REPRESENTATION BY HOLDER OF GENERAL TESTAMENTARY POWER OF APPOINTMENT. To the extent there is no conflict of interest between the holder of a general testamentary power of appointment and the persons represented with respect to the particular question or dispute, the holder may represent and bind persons whose interests, as permissible appointees, takers in default, or otherwise, are subject to the power.

SECTION 303. REPRESENTATION BY FIDUCIARIES AND PARENTS. To the extent there is no conflict of interest between the representative and the person represented or among those being represented with respect to a particular question or dispute:

(1) a [conservator] may represent and bind the estate that the [conservator] controls;

(2) a [guardian] may represent and bind the ward if a [conservator] of the ward's estate has not been appointed;

(3) an agent having authority to act with respect to the particular question or dispute may represent and bind the principal;

(4) a trustee may represent and bind the beneficiaries of the trust;

(5) a personal representative of a decedent's estate may represent and bind persons interested in the estate; and

(6) a parent may represent and bind the parent's minor or unborn child if a [conservator] or [guardian] for the child has not been appointed.

SECTION 304. REPRESENTATION BY PERSON HAVING SUBSTANTIALLY IDENTICAL INTEREST. Unless otherwise represented, a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented by and bound by another having a substantially identical interest with respect to the particular question or dispute, but only to the extent there is no conflict of interest between the representative and the person represented.

Elements of UTC NJSA

Examining UTC Section 111, it is clear that a number of difference elements have to be addressed when drafting an effective NJSA. The elements of a valid NJSA are as follows"

The NJSA must be signed by all "interested persons;"

The action taken in the NJSA must be based on a statutory or common law; and

The NJSA must not violate the settlor's material purposes in establishing the trust.

Hypothetical.

For the purposes of the following discussion, assume that an irrevocable trust provides for discretionary income and principal distributions to the child of the deceased settlor and upon the child's death, the trust terminates and all assets are distributed to the "then living descendants" of that child. XYZ trust company (a large national trust company), successor in interest to ABC Trust

Company that is named in the trust document, is acting as trustee of the trust. The child wants to remove XYZ trust company as the trustee and have DTC ("directed trust company"), which is a small local trust company, appointed as the new trustee of the trust so her investment advisor Anti-Matter Consulting can invest the trust assets. It is also been proposed to insert directed trustee provisions into the trust document. The child who is the current beneficiary is age 35 is married and has 2 minor children.

Interested Persons.

Section 111(b) states that a NJSA must be entered into by all "interested persons." Section 111(a) defines "interested parties" as those persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by the court. Note that this special definition used for purposes of NJSAs is different from, but related to, other definitions used in the UTC. UTC Section 103(3) defines "Beneficiary" as … "a person that has a present or future beneficial interest in a trust, vested or contingent…" UTC Section 103(13) defines a "Qualified Beneficiary" as "…a beneficiary who, on the date the beneficiary's qualification is determined is a distributee or permissible distributee of trust income or principal; would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date without causing the trust to terminate; or would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date." Qualified Beneficiaries are a subset of "Beneficiaries." However, the use of either term in a NJSA can create problems if an analysis has not been performed as to the class of "interested persons" as defined in UTC Section 111(a). Rarely will a trust's Qualified Beneficiaries constitute all of the trust's interested persons for NJSA purposes. It is more likely that the class of interested persons will be the same as the trust's "Beneficiaries."

In most cases, interested parties are going to be anyone who would have to be joined in a court action as a necessary party if a court action was filed instead of the utilization of a NJSA. the trustee of the trust will always be an interested person, as the Trustee must be bound by the NJSA in order to be compelled to comply with the NJSA and to protect the Trustee in complying with its provisions. The key question in determining which trust beneficiaries are interested persons is which beneficiaries' interests in the trust would actually or potentially be effected by the terms of the NJSA. While relief addressed by the NJSA may be so limited that the interests of not all trust beneficiaries are actually or potentially affected, it would be quite unusual for a court to approve a settlement agreement in a case without all parties to that action signing off.

In the Hypothetical, XYZ trust company and DTC must be parties, as XYZ must be bound by the NJSA removing it and DTC will need a document appointing it as the successor trustee. Both XYZ and DTC will also want king size releases from all of the beneficiaries anyway from various potential liabilities. The child must be a party as her interests can very well be affected by the change of trustee and the Trustees, both incoming and outgoing, will want releases from the child.

The child's descendants are also interested parties. The appointment of a successor trustee always has the potential to affect the interest of any beneficiary. In this case where the incoming trustee is merely a directed trustee, is a small trust company compared to the exiting trustee, and where it is clear that the child's investment advisor will be investing trust assets, it is possible that the new trustee will take action (or fail to take action) that would benefit the child to the detriment of the child's descendants. However, the minor children cannot be direct parties to the NJSA because they are minors and must be represented by another party under the UTC representation rules. In this case, the child should not be the representative of her children because there is a potential conflict. However, as the child's spouse is not a beneficiary of the trust, that spouse should be able to be the representative for the minor child as there is no direct conflict of interest. But that does not necessarily also create representation for the unborn children of the child. The spouse could represent the spouse's unborn children who may be beneficiaries of the trust, but that would not include unborn children of the child who were not also children of the spouse. More importantly is the representation of the descendants of the minor children. A parent may only represent and bind his or her children under UTC section 303(6). It has been argued that a parent representing a minor child stands in the shoes of that minor child and thus under UTC section 304(6) can virtually represent anyone that the minor child could represent if he or she was an adult and had a substantially identical interest. However, UTC section 303(6) seems quite specific about whom a parent can represent. Thus, there needs to be a person who has a "substantially identical interest" under UTC section 304 to represent the descendants of the child's minor children's descendants e.g. an adult remainder beneficiary. The only option is for a limited court action to be filed for a court to appoint a representative for the child's minor children's descendants under UTC section 305. If we slightly alter the Hypothetical, and assume that the child has one adult child then that adult child could represent any remainder beneficiary of the trust, including his or her minor siblings as well as any unborn descendants, as the adult child's interest in the trust would be substantially identical to any other remainder beneficiary.

Another option regarding representation of minor descendants may exit if trust property, instead of passing outright to the descendants of the child, passes into trusts for the benefit of each descendant. UTC section 303(4) states that a Trustee may represent and bind the beneficiates of a trust. Thus, in that case, the interested person is not a descendant, but rather is the Trustee of each descendant's trust. This makes the trustee of each of those trusts the interested person for purposes of a NJSA and those trustees entering into the NJSA will bind all beneficiates of each of those trusts to the NJSA provisions. Technically, once the Trustee of the trust in question is a party to a NJSA, then any beneficiary of that trust, if not a party to the agreement or otherwise represented, can be represented by the Trustee, assuming there is not conflict of interest.

Most cases are not as easy as the Hypothetical. Let's also assume that there is a clause in the trust document that provides for distribution of assets in the event that the child dies without any descendants. Half of the assets are directed to be distributed to Shriners Hospital and the other half of the assets are directed to be distributed to the settlor's "heirs" at law. The first analysis is whether these contingent beneficiaries would be necessary parties to a court action. In a case dealing with non-fault removal when requested by all Qualified Beneficiaries of the trust, the court in *Davis v. U.S. Bank*, supra, held that contingent remainder beneficiaries of a trust were not necessary parties to that trustee removal action. As the court's ruling seems to be based on an incorrect reading of the no fault removal statute, R.S.Mo. § 456.7-706.4 this case may not be able to relied upon outside of such an action. If the conclusion is that Shriners would be a necessary party in a court action, then they would be an interested party for purposes of a NJSA. It would seem that the trustee of the trust, if a party, could represent and bind Shriners.

That brings us to the status of the settlor's "heirs." A settlor's heirs are unknown until the event happens that makes them "heirs, e.g. in this case the death of the child without descendants. That would seem to make the identity of the "heirs" of the settlor unascertainable at the time the NJSA is entered into. Thus a remainder beneficiary of the trust, such as an adult child of the settlor's child, should be able to virtually represent the settlor's unascertained "heirs" who are also remainder beneficiaries. The "heirs" also may be represented by the trustee of the trust.

Statutory or Common Law Basis for NJSA.

UTC Section 111 provides that a NJSA must include "…. terms and conditions that could be properly approved by the court under this [Code] or other applicable law…" Thus a NJSA must set forth a legal basis for the relief that is being sought by the creation of the NJSA. In the Hypothetical, UTC Section 704(c) provides that "[A] vacancy in a trusteeship of a noncharitable trust that is required to be filled must be filled in the following order of priority: (1) by a person designated in the terms of the trust to act as successor trustee; (2) by a person appointed by unanimous agreement of the qualified beneficiaries; or (3) by a person appointed by the court." This section would give a court the authority to appoint a Trustee in the event of a resignation of a current trustee, if that resignation would create a vacancy. Thus in the NJSA addressing the issues raised in the Hypothetical, the provisions would need to address the power of the court to appoint a Trustee in the event of a vacancy. The Hypothetical assumes that XYZ Trust is willing to resign and that the trust document does not appoint another Trustee in the event that XYZ trust company resigns.

It is always a good idea to insert as many legal basis for the relief granted in the NJSA as possible. As UTC Sections 411 through 417 set forth various methods for modifying or terminating trusts, it is always a good idea to scan these statutes and include as many as seem to be applicable to any particular NJSA. Those Section are: Section 411 Modification or Termination of Noncharitable Irrevocable Trust by Consent; Section 412 Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively; Section 413; Cy Pres; Section 414; Modification or Termination Of Uneconomic Trust; Section 415 Reformation To Correct Mistakes; and Section 416. Modification to Achieve Settlor's Tax Objectives. Section 411 is always a good statute if the Settlor is alive and you can obtain the consent of the settlor and all the beneficiaries and having the settlor consent will not result in adverse tax consequences for the settlor. Note that a Settlement Agreement under UTC Section 411 is really not a NJSA, because Section 411 allows modification of a trust, "even if the modification or termination is inconsistent with a material purpose of the trust," unlike UTC Section 111 that does not allow a NJSA to change a material purpose of the trust, see discussion below. In most states, such a modification or termination does not even require court action, so that section can be used as an independent basis for a settlement agreement other than UTC Section 111.

UTC section 412 can often time be used as a legal basis for an NJSA as it is so broad.

SECTION 412. MODIFICATION OR TERMINATION BECAUSE OF UNANTICIPATED CIRCUMSTANCES OR INABILITY TO ADMINISTER TRUST EFFECTIVELY.

(a) The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the settlor's probable intention.

(b) The court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration.

(c) Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust.

For example in the Hypothetical it can be argued that the settlor did not anticipate that XYZ Trust Company would absorb ABC Trust Company and then resign. It can be inferred that the Settlor intended there to be a corporate trust company, so DTC seems to fit the bill. In Missouri, the second part of that statute was changed to read "The court may modify the management or administrative terms of a trust if modification will further the purposes of the trust." In Missouri, this section can be used as the legal justification for many a NJSA.

Note that UTC Section 111 is not limited to a NJSA regarding non-charitable trusts. Thus Section 413, Cy Pres, can be used to modify or terminate charitable trust that has a charitable purpose that has become "…unlawful, impracticable, impossible to achieve, or wasteful. However one must always consider whether the state's Attorney General is an "interested person" for purposes of a NJSA. This will depend on state law and whether or not there are specific charities who are the beneficiaries of the charitable trust.

Section 414(a) authorizes a trustee to terminate a trust of less than a stated value which may differ from state to state without a court order and a Trustee may do so without a NJSA. However, even with that authority trustees sometime will still want the protection of a NJSA with a release to terminate a trust equal to or below the statutory limit. Section 414(b) also authorizes the court to terminate a trust if a court determines that the value of the trust assets are insufficient to justify the cost of administering a trust even if the assets are of a trust are in excess of the statutory limit. That subsection can be used as the legal underpinnings of a NJSA terminating a trust as uneconomic with assets valued over the statutory limit.

Section 415 allows broad relief for reforming a trust document for a mistake, whether or not the mistake is unambiguous and whether or not the mistake is in the expression or the inducement. Existence of the mistake be proved by clear and convincing evidence. While this section is helpful in using as the basis for a NJSA, the evidentiary standard is tough to meet. On the other hand if all the interested persons have agreed in a NJSA that the evidence showing the mistake is clear and convincing, then it would be difficult for such person to latter file a court pleading saying the NJSA is not valid because the evidentiary standard was not met.

UTC Section 416 provides that court with the authority to modify the terms of a trust to achieve the settlor's tax objectives, but in a manner that is not contrary to the settlors probably intention. This statute quite useful the legal basis for a NJSA that is attempting to fix a document where the estate, gift or generation skipping transfer tax consequences of a trust document can be improved. However, just because a modification will result in more efficient taxation is not necessarily sufficient. *In the Trust Created Under Last Will and Testament of Darby*, 234 P.3d 793 (Kan. 2010), the Kansas Supreme Court denied a reformation based on the Kansas version of this section on the grounds that mere proof that there is a more tax efficient manner in which to draft a trust is not in and of itself sufficient to justify a modification under the statute.

Maintenance of the Trust's Material Purposes.

American common law regarding trust beneficiaries power to consent to a trust's modification and termination for many years has in part been controlled by the "*Claflin*" doctrine, *Claflin v. Claflin*, 149 Mass. 19, 20 N.E. 454 (1889). The Claflin court refused to adopt the English common law rule that trust beneficiaries could consent to a change in a trust, or its termination, even though a material purpose of the settlor who established in the trust was frustrated. *Saunders v. Vautier*, 4 Beav. 115, aff'd, Cr. & Ph. 240 (1841). The Claflin doctrine applicable in almost all U.S. jurisdiction provides that a trust cannot be modified or terminated on the consent of all the trust beneficaires, if the modification or termination would violate or frustrate a material purpose of the settlor in establishing the trust.

The Claflin doctrine is alive and well in the UTC[2] and is embedded in the UTC Section 111 requirement that a NJSA cannot violate a material purpose of the trust. While the concept of a material purpose is easy to understand, it can be quite difficult to analyze in practice. In the Hypothetical, the question becomes whether replacing the corporate trustee with another corporate trustee and inserting the directed trust language in the trust document is contrary to a material purpose of the settlor in establishing the trust. The settlor originally created the trust with ABC Trust Company as the trustee. However, ABC Trust Company was taken over by XYZ trust company. It would be hard to argue that the identity of a trust company serving as trustee that was unknown to the settlor was a material purpose in establishing the trust. Perhaps if it was still ABC Trust Company and settlor had a particular relationship with that trust company, ABC Trust Company's appointment could be a material purpose of the trust. Could having a trust company as the trustee be a material purpose? Clearly yes, but the successor Trustee, DTC, is also a corporate trust company. The only factor that could indicate a violation of a material purpose is the insertion of the directed trust provisions in the trust. Was having a corporate trustee in charge of trust investments a material purpose of the settlor?

[2] The Missouri version of the UTC contains a non-uniform provision, R.S.Mo. Section 456.4-411B Modification or termination of non-charitable irrevocable trust by consent—applicability, that does allow a consensual modification or termination of a trust, even if that modification or termination violates a material purpose of the trust. This section is based on prior R.S.Mo. Section 456.590, which was repealed in 2004.

It would be a rare that a change in the administrative provisions would violate a material purpose of the settlor. On the other hand, consider a trust term that mandates investments will only be in AAA rated corporate bonds paying a minimum of 3% interest. It is hard to argue that a material purpose of the settlor was not to restrict investments to very conservative fixed income assets. Would a NJSA removing this restriction be valid? It is always highly likely that any change in the dispositive provisions of a trust will impact a material purpose of a trust. Assume that the intent of the NJSA is to change the distribution language in the trust for the child from health and education, to health, support, maintenance, and education. A material purpose of the settlor can be seen as limiting distributions to those two restrictive standards so that more trust property would pass to the remaindermen. It is hard to imagine any situation where removal of a beneficiary or a premature trust termination does not impact a material purpose of the settlor. However, what if the contingent distribution clause is solely to the settlor's heir? Does changing that clause to the child's wife violate a material purpose of the settlor? One can argue that placing the heirs in the ultimate distribution clause does not show a purpose of benefiting the settlor's heir, but rather just the avoidance of probate administration. Thus eliminating the heirs would not violate the settlor's material purpose in establishing the trust. From a trust drafting perspective, if a settlor is concerned about the trust being changed, the trust document should contain a list of what the Settlor feels is the material purposes in establishing the trust. Moreover, UTC Section 111 is not a mandatory statutory provisions under UTC Section 105 and a provision can be inserted in a trust that a NJSA may not be used to modify the terms of the trust or terminate it sooner than provided in the trust agreement.

Drafting NJSAs

In drafting a NJSA, the first important point is to make sure that all interested parties are parties to the agreement. Because in an NJSA there is no provision for testing who is an interested person (e.g. a motion to join necessary parties), out of excess caution the best course is to have the trustee and all beneficiaries and anyone else that may have an interest in the Trust to be a direct or represented party to the NJSA. It is also wise to have detailed recitals as to who are the interested parties and the specific basis for any representation of person who are not direct parties. In describing the basis for representation, specific statutes should be cited, but also each party to the agreement should be deemed to represent any other beneficiary of the trust "as allowed by applicable law." That should give duplicate basis for the representation of parties who are not direct signatories of the NJSA.

As many statutory and common law basis supporting the NJSA should be explicitly set forth in the NJSA with analyses of why those basis apply to the NJSA. It should also be clear from the NJSA why the material purpose of the settlor is not being violated thus binding all parties to this proposition. It is also important that the NJSA have a backup in the case that a court ever decides that the NJSA is not valid because not all interested persons are parties, no statutory or common law basis exists to support the NJSA, or the NJSA violates a material purpose of the settlor. In that event, the result of having an invalid NJSA is that the Trustee can be sued for breach of trust for acting in according with the terms of an invalid agreement. UTC section 1009 provides that a beneficiary can consent to a trustee's breach of trust.

SECTION 1009. BENEFICIARY'S CONSENT, RELEASE, OR RATIFICATION. A trustee is not liable to a beneficiary for breach of trust if the beneficiary consented to the conduct constituting the breach, released the trustee from liability for the breach, or ratified the transaction constituting the breach, unless:

(1) the consent, release, or ratification of the beneficiary was induced by improper conduct of the trustee; or

(2) at the time of the consent, release, or ratification, the beneficiary did not know of the beneficiary's rights or of the material facts relating to the breach.

Thus, a NJSA should also provide that all beneficiaries are consenting to any breach of trust that may occur if the NJSA is held invalid. Importantly, in general and specifically for supporting the consent to breach provisions, a NJSA should recite that all beneficiaries either had advice from legal and other advisors or was advised to and had the opportunity to consult with such advisors, is aware of all material facts regarding the NJSA, had every right to request and review relevant documents and materials, and in fact has reviewed all relevant document and materials.

DECANTING

Introduction

There does not seem to be any statutory or case authority to decant in any of Arkansas, Kansas, Oklahoma[3], Iowa or Nebraska. Missouri enacted at Mo. Rev. Stat. § 456.4-419 in 2011 which was made a part of the MUTC. While the statute specifically authorizes decanting of trusts created by Missouri law, that power probably existed in common law prior to the enactment of the statute. [4] Decanting is a fancy name for a trustee exercising a discretionary distribution power set forth in a trust document to have assets of that trust (the "first trust") pass ("decant") to another trust (the "Second Trust"), whether that be an existing trust or a trust created by the Trustee or other third party. This gives the Trustee power to have the trust assets end up in a trust that can be governed by quite different provisions that the original trust.

The Missouri Bar is in the process of revising Mo. Rev. Stat. § 456.4-419. Many state legislatures have enacted decanting statutes over the last decade and the Uniform Law Commissioners have created a Uniform Decanting statute which has been enacted is seven states. The addition of a decanting statute in the MUTC gave planners another arrow in their quiver of tools to modify irrevocable trust documents. The major structural distinction is the technically, assuming an independent trustee, no beneficiary has to consent to the decanting which can thus change the provisions of a trust without any action on behalf of the trust beneficiaries. This provides a way to modify a trust that is perhaps better from an estate, gift, and generation skipping transfer tax perspective. The transfer tax effects of decanting are beyond the scope of this outline,

[3] Save the Wealth! Trust Decanting and Oklahoma. Tara M. Niendorf, 66 Okla.L.Rev. 615 (2014).

[4] See *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940), Mo. Rev. Stat. § 456.4-419.6.

but are important factors that must be taken into consideration when a decanting is being considered or structured.

The Statute: § 456.4-419

The statute has six subsections and imposes a variety of requirements and restrictions on the decanting process.

> 1. Unless the terms of the trust instrument expressly provide otherwise, a trustee who has discretionary power under the terms of a trust to make a distribution of income or principal, whether or not limited by an ascertainable standard, to or for the benefit of one or more beneficiaries of a trust, the "first trust," may instead exercise such discretionary power by appointing all or part of the income or principal subject to such discretionary power in favor of a trustee of a second trust, the "second trust," created under either the same or different trust instrument in the event that the trustee of the first trust decides that the appointment is necessary or desirable after taking into account the terms and purposes of the first trust, the terms and purposes of the second trust, and the consequences of the distribution.
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> 2. The following provisions apply to any exercise of the authority granted by subsection 1 of this section:
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> (1) The second trust may have as beneficiaries only one or more of those beneficiaries of the first trust to or for whom any discretionary distribution may be made from the first trust and who are proper objects of the exercise of the power, or one or more of those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust at a time or upon the happening of an event specified under the first trust;
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> (2) Unless the exercise of such power is limited by an ascertainable standard, no trustee of the first trust may exercise such authority to make a distribution from the first trust if:
>
> (a) Such trustee is a beneficiary of the first trust; or
>
> (b) Any beneficiary may remove and replace the trustee of the first trust with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code;
>
> (3) Except if participating in a change that is needed for a distribution to any such beneficiary under an ascertainable standard, no trustee shall exercise such authority to the extent that doing so would have the effect either of:
>
> (a) Increasing the distributions that can be made in the future from the second trust to the trustee of the first trust or to a beneficiary who can remove and replace the

trustee of the first trust with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code; or

(b) Removing restrictions on discretionary distributions imposed by the instrument under which the first trust was created;

(4) In the case of any trust contributions which have been treated as gifts qualifying for the exclusion from gift tax described in Section 2503(b) of the Internal Revenue Code, by reason of the application of Section 2503(c), the governing instrument for the second trust shall provide that the beneficiary's remainder interest shall vest no later than the date upon which such interest would have vested under the terms of the governing instrument for the first trust;

(5) The exercise of such authority may not reduce any income interest of any income beneficiary of any of the following trusts:

(a) A trust for which a marital deduction has been taken for federal tax purposes under Section 2056 or 2523 of the Internal Revenue Code or for state tax purposes under any comparable provision of applicable state law;

(b) A charitable remainder trust under Section 664 of the Internal Revenue Code;

(c) A grantor retained annuity trust under Section 2702 of the Internal Revenue Code; or

(d) A trust which has been qualified as a Subchapter S trust under Section 1361(d) of the Internal Revenue Code or an electing small business trust under Section 1361(e) of the Internal Revenue Code;

(6) The exercise of such authority does not apply to trust property subject to a presently exercisable power of withdrawal held by a trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions, unless after the exercise of such authority, such beneficiary's power of withdrawal is unchanged with respect to the trust property; and

(7) A spendthrift clause or a provision in the trust instrument that prohibits amendment or revocation of the trust shall not preclude the trustee from exercising the authority granted by subsection 1 of this section.

3. At least sixty days prior to making a discretionary distribution under subsection 1 of this section, the trustee of the first trust shall notify the permissible distributees of the second trust, or the qualified beneficiaries of the second trust if there are no permissible distributees of the second trust, of the distribution. A beneficiary may waive the right to the notice required by this subsection and, with respect to future distributions, may withdraw a waiver previously given.

4. In exercising the authority granted by subsection 1 of this section, the trustee shall remain subject to all fiduciary duties otherwise imposed under the trust instrument and Missouri law.

5. This section does not impose on a trustee a duty to exercise the authority granted by subsection 1 of this section in favor of another trust or to consider exercising such authority in favor of another trust.

6. This section is intended to codify and, from and after enactment, to provide certain limitations to the common law of this state, and this section applies to any trust governed by the laws of this state, including a trust whose principal place of administration is transferred to this state before or after the enactment of this section.

Missouri Decanting Requirements

Examining MUTC Section 456.4-419, it is clear that a number of different elements have to be addressed to determine if decanting is available in a specific situation and to accomplish the decanting. The elements of a valid decanting are as follows:

The terms of the trust document that creates the trust that is desired to be decanted must (i) confer on the Trustee the discretionary power to make distributions of income or principal to one or more beneficiaries regardless whether or not that power is limited by some ascertainable standard, and (ii) if so, not prevent the trustee from exercising that discretionary power to distribute trust assets to another trust;

The exercise of the trustee's discretion for assets to be distributed to a second trust must be necessary or desirable "…after taking into account…" the terms and purposes of the first trust, the terms and purposes of the second trust, and the consequences of the distribution;

The second trust must have at least one beneficiary of the first trust, regardless of how remote or contingent that beneficiary may have been in the first trust:

The Trustee must give notice of the discretionary distribution to the second trust to the permissible distributees, if any, or if none, to the qualified beneficiaries, of the second trust sixty days or more prior to the exercise;

The decanting must be consistent with and not in violation of the Trustees fiduciary duties; and

The proposed decanting must not be prohibited by the provisions of Section 2 of the decanting statute because of tax sensitive nature of the trust to be decanted as described in that section of the statute.

The Terms of the Trust.

It will be the rare case under the Missouri decanting statute for the terms of the trust to prevent exercise of the statutory decanting power. First, almost all trusts contain a discretionary power to make distributions. For the power to allow for decanting it has to be discretionary, but it can be over income or principal or both, exercisable in favor of one or more beneficiaries, and unlimited or limited by an ascertainable standards, such as for a beneficiary's health, support, maintenance, and education. This last provision makes the Missouri Statute quite different compared to other decanting statutes enacted by other states, in which decanting is either not available or very limited where the discretionary power relied upon is limited by an ascertainable standard. The only case where decanting would not be available under the Missouri statute would be where a trust contains only mandatory distributions provisions, such as "…distribute to the beneficiary one thousand dollars a month…" or "distribute the net income of the trust at least annually." But even if a trust contained that language, it would be rare for the trust terms to not also include some type of additional discretionary power over remaining trust assets, even if it limited for the beneficiaries health and/or education. But note that the statute only allows a trustee to decant trust assets over which that trustee has the discretion. One has to ask if that makes much sense. For example, assume a trust has a mandatory income provision, with a discretionary principal distribution provision. If the Trustee decants the principal and leaves whatever undistributed or accrued income in the first trust, all *future* income will be subject to the terms of the second trust, which could make income distributions wholly discretionary without any ascertainable standard. On the other hand if a trust allows discretionary distributions of income, but not principal (which admittedly would be odd), then only the income could be decanted. So presumable the first trust would stay in existence and all income would periodically be distributed to the second trust.

Is Decanting "Necessary or Desirable"

In order to decant, a trustee must determine that the exercise of the Trustees discretion to distribute assets of the first trust to the second trust is "necessary or desirable." In making that determination the trustee must "take into account" the terms and purposes of the first trust, the terms and purposes of the second trust, and the consequences of the distribution. Note that this is the only place in the statute which allows the Trustee to consider the purpose of the first trust. As noted above, the "*Claflin*" doctrine prevents the modification of most trusts in most jurisdictions if a material purpose of the settlor in establishing the trust is violated. A trustee may decant a trust even if the provisions of the second trust violate a material purpose of the settlor in establishing the first trust because the trustee is required to "take into account" the terms and purposes of the first trust ***and*** the second trust.

Let's assume that the terms of the first trust provide for discretionary distributions of income or principal for the settlor's daughter and that daughter's children for any of their health, support, maintenance, and education. The Trustee of the first trust determines that the daughter is living a lifestyle which the Trustee views as sinful. There is a second trust in existence which provides for the discretionary distribution of income and principal to only the daughter's children.

The Trustee decants all assets of the first trust to the second trust, which now provides that only the daughter's children may receive discretionary distributions. The Trustee has "taken into account" both the terms and purpose of both trusts and the consequences of the distribution to disinherit the settlor's daughter, which was clearly a material purpose for which the settlor established the first trust. The trustee of the first trust may very well feel that this modification was "desirable" to discourage or punish the daughter from continuing to pursue her sinful lifestyle.

Is the Beneficiary of the Second Trust a Beneficiary of the First Trust

The results of the above hypothetical illustrate this requirement. The overall rule is that you can eliminate beneficiaries of the first trust, but you can't add beneficiaries to the second trust that were not in the first trust. The second trust must have either one or more beneficiaries "…to or for whom any discretionary distribution may be made from the first trust and who are proper objects of the exercise of the power…" ***or***, "…one or more of those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust…" (Emphasis added). The proposed revision to the decanting statute would require that at least one "permissible distributee" (e.g. a current beneficiary) of the first trust must also be a permissible distributee of the second trust.

Let's assume that the terms of the first trust provide that only the settlor's daughter can receive discretionary distributions of income or principal for the daughter's health support maintenance and education and further provide that on the daughter's death, trust assets pass to the daughter's then living children and if there are none, then to the settlor's nieces and nephew. The Trustee of the first trust decides that the daughter is living a lifestyle contrary to the Trustee's beliefs and that the daughter is indoctrinating her children in that same lifestyle. The Trustee creates a second trust, the sole current beneficiary of which is the nieces and nephews of the settlor, who also happens to be the children of the Trustee. The nieces and nephews are "beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust…" Thus the Trustees actions would be perfectly permissible under the decanting statute, unless there is a breach of trust, which is discussed below.

Notice

The statute requires that notice of the decanting be given only to the permissible distributees of the second trust, and if none, then to the qualified beneficiaries of the second trust. The MUTC defines a permissible distributee as "a beneficiary who is currently eligible to receive distributions of trust income or principal, whether mandatory or discretionary"[5] and "qualified beneficiary" means "a beneficiary who, on the date the beneficiary's qualification is determined: (a) is a permissible distributee; (b) would be a permissible distributee if the interests of the permissible distributees described in paragraph (a) of this subdivision terminated on that date; or (c) would be a permissible distributee if the trust terminated on that date."[6] In the hypothetical set

[5] R.S.Mo. Section 456.1-103(16)

[6] R.S.Mo. Section 456.1-103(21)

for immediate above, the Trustee would only have to give 60 days' notice of the decanting to the settlor's nieces and nephew as they are the permissible beneficiaries of the second trust. ***No notice is required to be given to the settlor's daughter or her children, who are the beneficiaries that are being disinherited by the action of the Trustee.*** The Missouri Bar proposed revision of the decanting statute would require the notice be sent to all of the permissible distributees of the first trust and the second trust.

Fiduciary Duties.

Section 4 of the statute provides that the Trustee must exercise a decanting power consistent with that trustees fiduciary duties. In the hypothetical above, it is clear that a trustee can drastically alter the provisions of a trust by decanting. Section 4 was inserted into the statute to make it clear that there are significant limitations on a trustee's power to decant a trust. Generally, a Trustee has a fiduciary obligation to administer a trust in good faith in accordance with its terms and applicable law, Restatement Third Trusts Section 76, UTC Section 801. Applied literally this would mean that a Trustee could never decant in a manner that would change the terms of a trust. However as noted above, the law of trust has also always provided various manners in which a trust can be modified by a court, Restatement Third Trusts, Part 5, UTC section 411 to 417. As we have seen one of the requirements of a NJSA is that there must be a legal basis for the trust modifications accomplished by such an agreement. Viewing decanting as just another method of accomplishing a non-judicial modification, a trustee that modifies the terms of a trust through decanting can only do so if one of the legal basis for trust modification or termination exist. Otherwise it's a violation of the Trustee's duty to administer the trust in accordance with its terms.

Let's analyze whether there is any breach of fiduciary duty in the first hypothetical in this section where a trustee decanted trust assets to eliminate the life estate of the settlor's daughter in favor of the daughter's descendants. The Trustee could base the elimination of the settlor's daughter as a beneficiary on the fact that circumstances have changed since the settlor's death on the grounds that settlor was opposed to the sinful lifestyle into which the settlor's daughter had fallen and would not have included the daughter as a beneficiary if she had been living that lifestyle during the life of the settlor. This theory could also apply to the second hypothetical, the elimination of the daughter and her descendants as beneficiaries and the substitute of the settlor nieces and nephews as current beneficiaries. However, in that case, the fact that the new beneficiaries are the children of the trustee constitute a violation of the Trustee's duty of loyalty. The duty of loyalty creates a strict prohibition on the trustee creating a conflict of interest where the Trustee may owe loyalty to those other than the trust beneficiaries, Restatement Third, Trusts, section 78, comment e. Thus decanting the trust into a trust with the trustee's children as the current beneficiaries would likely violate that trustee's duty of loyalty to the beneficiaries and may be voidable by those beneficiaries, UTC Section 802.

Prohibited Actions

Subsections (2) to (6) creates various tax related bright line prohibitions to decanting. Subsections (2) and (3) prevent a trustee who is also a beneficiary from exercising the decanting in a manner that will result in trust assets being included in the trustee/beneficiary's estate for federal estate tax purposes under Section 2041 of the Internal Revenue Code of 1986 as amended, (the "Code"). Subsection (4) prevents a trust that qualifies as a recipient of annual exclusion gifts under Section 2503(c) of the Code from vesting at a time different than that in the first trust. Subsection (5) prohibits a trustee from decanting a trust in a manner that that reduces a beneficiary's income interest if that trust qualified for the marital deduction for federal estate or gift tax purposes, a charitable remainder trust, a grantor retained annuity trust, or a Qualified Subchapter S Trust or an electing small business trust. Subsection 6 prohibits the alteration of any presently exercisable power of withdrawal held by any trust beneficiary.

DISCLAIMERS[7]

I. Introduction

A. Estate planning attorneys have been living with Section 2518 and Section 2046 since 1976. These Sections set forth specific rules governing the circumstances under which a refusal by a beneficiary of an inter-vivos or testamentary transfer (commonly called a "renunciation" under state law and a "disclaimer" for federal gift and estate tax purposes) will be respected for federal transfer tax purposes. The effect of meeting the statutory requirements is that the disclaimed interest is treated as never having been transferred to the person making the disclaimer, Section 2518 (a). All of the operative rules and regulations governing disclaimers are contained in Section 2518.

B. Originally the regulations under Section 2518 were promulgated on August 6, 1986, T.D. 8095. The Regulations were extensively modified as they relate to the disclaimers of joint property on 12/30/97 by T.D.8744, for reasons set forth below.

C. The original Missouri disclaimer statute, 474.490 *Repealed*, was repealed in 1997 and twelve new sections were enacted, Sections 469.010 through 469.120. These statutes provide guidance with respect to state law requirements of disclaimers, although the statutes specifically do not abrogate the common law governing renunciations and disclaimers that existed prior to the enactment of the first disclaimer statute in 1982.

1. A disclaimer that is valid under the Missouri statutes or common law is not necessarily valid for federal estate and gift tax purposes. Major differences between the rules set forth in Section 2518 and those in Chapter 469 are highlighted in this outline.

2. Even if the requirements of Chapter 469 are not met, Missouri case law prior to the enactment of the effective date of the statutes (August 13, 1982), may allow a renunciation to be made that is valid under state law (but not for transfer tax purposes).

[7] This section only discusses Missouri law. Other applicable jurisdictions have statutes on disclaimers: Iowa, I.C.A. T. XV, Subt. 4, Ch. 633E; Nebraska, Neb.Rev.St. § 30-2352; Kansas, K.S.A. 59-2291, Oklahoma, 60 OK ST T. Ch. 15; Arkansas, 28 AR ST Subt. 1, Ch. 2, Subch. 2.

a. A question arises as to whether Chapter 469 preserves prior law completely, or just would allow a disclaimer if the prior rules would allow it, but change prior law where it is more restrictive.

  i. For example, prior law made a distinction between the effect of disclaimers of testate and instate interest, the latter being impossible to disclaim. In *Bostian v. Milens* 193 S.W.2d 797 (1946) the creditors of an intestate beneficiary were able to obtain the beneficiary's disclaimed intestate interest because the court held that such interest passed at death by force of law. The court stated that intestate heirs "have no power to prevent the passage of title to themselves by any renunciation, disclaimer and the like." 193S.W.2d at 801.

  ii. It has been suggested that Section 469.110 preserves this prior distinction, Borron, John A, Missouri Practice Volume 4A Supp. 1999.

    1) That Section states "This chapter does not abridge or effect the right of any person to transfer, release, disclaim or renounce any property, interest or power or elect against a will, under any other statute or under the common law."

    2) It can be argued that Section 469.110 speaks to the right of a person to disclaim, not to any restrictions that might apply to such right.

      a) That rights in disclaimed property would be affected by Chapter 469 and its predecessor statute, Section 474.490 *Repealed*, are acknowledged by the provisions of Section 469.120.

        i) That Section states "This chapter shall be effective with respect to any disclaimer made after August 13, 1982, except that rights which have vested pursuant to any such disclaimer shall not be distributed by the provisions of this chapter."

  iii. An interesting issue thus arises as to whether the language in Section 469.010 that clearly applies to intestate interests and that states "[f]or all purposes the disclaimed interest is deemed to have passed directly from the transferor to the ultimate taker or takers and is not subject to the claim of any creditor of the disclaimant" overrides the holding in the *Bostian* case, or whether that holding is preserved by the provisions of Section 469.110.

D. This outline sets forth the technical requirements of both Section 2518 and Chapter 469, discussing selected issues that may arise. The following section II of this outline includes a discussion of the new Regulations as they relate to the disclaimer of interests in joint property. The last section sets forth some factual situations where disclaimers can be very useful in post-mortem situations. Although not a magic bullet, many wounded or unsuitable estate plans can be saved or dramatically altered by the use of disclaimers.

E. As used in this outline, all references to federal estate and gift tax statutes are to the Internal Revenue Code of 1986, as amended, and all references to tax regulations are to current Treasury regulations, unless otherwise noted. All references to Missouri statutes are to the Revised Statutes of Missouri.

II. Effective Disclaimers

A. The usefulness of a disclaimer that is effective for the purpose intended (i.e. federal tax law, state law, or both) derives from the fact that no transfer is deemed to have occurred from the Disclaimant to those who receive the disclaimed interest.

B. Estate and Gift Tax Disclaimers.

1. To be effective for federal estate and gift tax purposes under Section 2518, a disclaimer must be a "qualified" disclaimer within the meaning of Section 2518 (b).

2. To be "qualified" the disclaimer must be:
   a. irrevocable and unqualified (Section 2518 (b));
   b. in writing (Section 2518 (b) (1));
      i. (the writing must identify the interest in property disclaimed and be signed by the disclaimant or the disclaimant's legal representative, Treas. Reg. 25.2518-2)
   c. received by the transferor of the interest, the transferor's legal representative, or the holder of the legal title to the property to which the disclaimed interest relates, within 9 months of the "transfer" creating the interest (or with 9 months of the disclaimant attaining age 21, if later), Section 2518 (b) (2); and
   d. made prior to the disclaimant accepting benefits of the disclaimed property (Section 2518 (b) (3)) .

3. In addition to the requirements set forth above, as a result of the disclaimer, the interest disclaimed must pass:
   a. without any direction on the part of the disclaimant (Section 2518 (b) (4)), and
   b. to a person other than the disclaimant (Section 2518 (b) (4) (B)).
      i. If the disclaimant is the "spouse of the decedent" then the property disclaimed may pass to, or into trust for the benefit of, the spouse (Section 2518 (b) (4) (A))
         1) Query, whether a spouse of the transferor of an inter-vivos transfer can disclaim a transfer and benefit from the disclaimed property.

4. The meaning of an "interest" in property for disclaimer purposes.
   a. Each interest in property that is separately created by a transferor can be disclaimed, Treas. Reg. Section 25.2518-3(a)(1).
      i. Examples of separately created interests, are:
         1) life estates;
         2) remainder interests;
         3) property severable under local law; and
         4) powers of appointment, whether general or special
      ii. Examples of interests that are not separately created.
         1) A term certain in a life estate (20 years for example)
         2) Income from specified assets in trust while income from other assets in the same trust are retained.

3) Specified rights in property, for example a person to whom a fee interest in property is transferred can't disclaim the right to income and retain the remainder.

b. A disclaimer can be made of an undivided portion of a separate interest in property, Treas. Reg. Section 25.2518-3(b).

c. A disclaimer can be made of a specified pecuniary amount of a transfer, Treas. Reg. Section 25.2518-3(c).

d. A disclaimer can be made by formula. See PLRs 8702023, 8637108, and 8624026.

5. The meaning of a "transfer" of an interest for disclaimer purposes.

a. The present regulations state that it is "the transfer creating the interest in the disclaimant," Treas. Reg. Section 25.2518-2(a)(3). This follows the wording of the statute, Section 2518(b)(2).

i. This is actually too broad a statement.

1) The rest of the regulations tie the commencement of the running of the 9-month time limit to any transfer that occurs for federal transfer tax purposes.

a) This is in accord with the regulations prior to their amendment in 1997, which specifically defined "transfer" as a "taxable transfer."

b) For example, the person to whom an interest passes because of the "exercise, release, or lapse of a general power of appointment" has nine months from the exercise, release or lapse to disclaim the transfer, but the taker in default of a non-general power must disclaim nine months from the date of the original creation of the power. Treas. Reg. Section 25.2518-2(a)(3).

c) If more than one taxable transfer takes place, the time period runs from the first transfer, Treas. Reg. Section 25.2518-2(a)(3).

i) If a gift is made that is also included in the transferor's estate for federal estate tax purposes, then the time period runs from the gift.

ii) If a trust is created for the benefit of a spouse that is qualified for the marital deduction under Section 2056(b)(7), the time for the remaindermen to disclaim runs from the date of the creation of the trust, not from the subsequent taxable transfer that occurs on the death of the spouse by reason of Sections 2044 or 2519.

b. The meaning of "transfer" for purposes of disclaiming interests in jointly held property.

i. When a person transfers property into joint tenancy with rights of survivorship or into tenancy by the entireties and any subsequent transfer requires the action of both tenants, two interests in property are created.

1) The transferor makes a completed gift of a one-half undivided interest in the property, while retaining a survivorship right in the transferred one-half (the "Outright Portion").

2) The transferor makes a gift of a survivorship interest in the undivided one-half interest in the property retained by the transferor (the "Survivorship Portion").

3) A different result occurs if the contributing tenant can unilaterally re-vest title in that tenant, see the discussion below.

ii. The regulations that were finalized in 1986 took a very restrictive view as to when a transfer occurred of the interests in property owned jointly with rights of survivorship. These and other rules regarding the disclaimer of such property made the disclaimer of interests in joint property almost impossible on the death of the first joint owner.

1) Treas. Reg. 25.2518-2(c)(4)(i), *Repealed*, as it read before it was replaced in 1997 stated that "[A] qualified disclaimer under Section 2518(a) of an interest or any portion of an interest in a joint tenancy or a tenancy by the entirety must be made no later that 9 months after the transfer creating the tenancy. Thus, a surviving joint tenant cannot disclaim any part of the interest, including the survivorship interest, if more than 9 months have passed since the transfer creating the joint tenancy. In addition, a joint tenant cannot make a qualified disclaimer of any portion of the joint interest attributable to consideration furnished by that tenant."

2) There were exceptions to this rule for tenancies in real property between spouses created before 1982, Treas. Reg. 25.2518-2(c)(4)(ii), *Repealed*, and for joint property interests that were not completed gifts for federal gift tax purposes under Treas. Reg. Section 25.2511-1(h)(4), Treas. Reg. 25.2518-2(c)(5), Example 9, *Repealed*.

iii. Thus, under the old regulations both the Outright Portion and the Survivorship Portion had to be disclaimed within 9 months of the creation of the tenancy. In almost all instances this made the disclaimer of the Survivorship Portion impossible as the tenancy was almost always created more than 9 months before the first tenant died and the need for the disclaimer was identified.

1) Additionally, the requirement that a person could not disclaim a joint interest to the extent that person had contributed to the jointly owned property created very difficult tracing issues and discriminated against a working spouse who had generally made the contributions and could not disclaim if he or she was the survivor.

iv. This position of the Service, as expressed in the 1986 Regulations was immediately challenged in court.

1) In *Kennedy v. Commissioner*, 51 T.C.M. 1598 (1986), *rev'd* 804 F.2d 1332 (7^{th} Cir. 1986), Mrs. Kennedy, a resident of Illinois, had disclaimed the undivided one-half interest (the Survivorship Portion) in Illinois realty acquired by her and her deceased husband in 1953 as tenants by the entireties that passed to her on her husband's death. Illinois law specifically provided that the survivorship interest was a separate interest for disclaimer purposes, and that tenancy by the entirety property was subject to partition. The tax court upheld the Services position that Mrs. Kennedy's disclaimer was a gift, because it was not made within 9 months from the date of the creation of the tenancy. The Seventh Circuit reversed. That court analogized the unilateral right of Mr. Kennedy to partition the property and destroy Mrs. Kennedy's survivorship interest as a general power of

appointment, which the Service admitted was subject to a disclaimer within 9 months of his death.

2) The tax court held to its position supporting the Service, but was consistently overturned by federal courts, *Dancy Est. v. Commissioner*, 872 F.2d 84 (4th Cir. 1989*) McDonald v. Commissioner*, 853 F.2d 1494 (8th Cir. 1988), *Hoffman v. U.S.* 85-2 USTC para.13,630 (D.Neb. 1984), and *Ferguson v. U.S*. 81-1 USTC para.13,409 (D. Ariz. 1981)

3) The Service finally capitulated in AOD 1990-06, in which it acquiesced to the Eighth Circuit's opinion in *McDonald*.

   a) The Service held in AOD 1990-06 that (1) where the joint tenancy is subject to partition or severance under state law, the "transfer" of the Survivorship Portion for purposes of the nine month limit occurs on the death of the first tenant and (2) whether or not the disclaiming tenant contributed or didn't contribute assets to the joint tenancy is irrelevant.

      i) The initial proposed amendments to the Section 2518 Regulations essentially maintained the Service's position as express in AOD 1990-06.

4) The Service's position was an improvement, but problems still remained.

   a) In Missouri, and other states where tenancy by the entireties property is not severable or subject to partition, a surviving spouse still could not disclaim the Survivorship Portion within 9 months after the first tenant's death.

      i) While a married couple in Missouri can own property as joint tenants with rights of survivorship, and not as tenancy by the entireties, the intent to do so must be very explicit. Most married couples purchasing or titling property have no idea of the possible transfer tax consequences of taking the title as joint tenants with rights of survivorship and not as tenants by the entireties. Additionally, there are non-tax advantage to owning property as tenancy by the entireties, such as protection from the creditors of one, but not both, of the spouses, *See Thummel v. Thummel*, 609 S.W.2d. 175, 180 (Mo. App. 1980).

v. The final amendments to the Section 2518 regulations issued on December 31, 1997, were a surprise to many estate planning practitioners because of their reasonableness and coherence.

1) With two exceptions for certain types of joint tenancies, the transfer of the Outright Portion occurs on the creation of the tenancy, and must be disclaimed by the disclaimant within nine months of that creation.

2) With two exceptions for certain types of joint tenancies, the transfer of the Survivorship Portion occurs on the death of the first tenant and such interest "is deemed to be a one-half interest in the property."

   a) This rule applies regardless of (1) which one of the joint owners contributed the assets to the jointly owned property and (2) whether or not the property was subject to partition or severance under local law.

      i) "This is the case regardless of the portion of the property attributable to consideration furnished by the disclaimant and regardless of the portion of the property that is included in the decedent's gross estate under section 2040 and regardless of whether the interest can be unilaterally severed under local law." Treas. Reg. 25.2518-2(c)(4).

vi. There are two exceptions to the new rule.

1) The first exception is for certain tenancies in real property between spouses where the spouse of the donor is not a United States citizen (as set forth in Section 2523(i)(3)),Treas. Reg. 25.2518-2(c)(4)(ii).

a) For purposes of Section 2523(i)(3) tenancies, the surviving spouse can disclaim any portion of the joint interest that is includable in the decedent's gross estate under Section 2040. See Treas. Reg. 25.2518-2(c)(5), example (9).

2) The second exception is with respect to certain joint bank, brokerage, and other investment accounts, Treas. Reg. 25.2518-2(c)(4).

a) This exception applies to certain joint bank accounts, brokerage accounts, and mutual fund accounts, contributions to which can be unilaterally regained under state law by the contributing tenant without consent of the non-contributing tenant. For gift tax purposes (Treas. Reg. 25.2511-1(h)(4)) the gift of any interest to a non-donor joint tenant is incomplete. The gift only becomes complete when the non-donor joint tenant withdraws funds from the account or the contributing joint tenant dies.

b) For disclaimer purposes, the transfer with respect to the 9 month period occurs upon (i) the withdrawal by the non-donor tenant, or (ii) the death of the contributing tenant.

c) The disclaimant cannot disclaim assets that he or she contributed to the account, See Treas. Reg. 25.2518-2(c)(5), examples (12), (13), and (14).

6. Acceptance of Benefits.

a. A person cannot disclaim any interest in property with respect to which he or she has "accepted benefits," Treas. Reg. 25.2518-2(d).

i. "Acceptance is manifested by an affirmative act which is consistent with ownership of the interest in property," Treas. Reg. 25.2518-2(d)(1).

1) Taking delivery of an instrument of title, in and of itself, is not acceptance, Treas. Reg. Section 25.2518-2(d)(1).

2) If the disclaimant receives two separate interests in property from the same source that can be independently disclaimed, acceptance of one is not acceptance of the other, Treas. Reg. Section 25.2518-2(d)(1).

3) A joint tenant of real property does not accept the benefits of the property just because he or she is residing in it, Treas. Reg. Section 25.2518-2(d)(1).

4) Actions taken by a disclaimant who is a fiduciary with respect to the disclaimed property do not constitute acceptance, so long as the disclaimant does not retain a wholly discretionary power to direct enjoyment of the disclaimed property. Treas. Reg. 25.2518-2(d)(2).

7. Passage Without Direction of The Disclaimant.
   a. The general rule is that "[a] disclaimer is not a qualified disclaimer unless the disclaimed interest passes without any direction on the part of the disclaimant to a person other than the disclaimant…," Treas. Reg. 25.2518-2(e)(1).
      i. The "without any direction" part of the rule is essentially satisfied if the interest disclaimed passes pursuant to the governing instrument or local law governing intestate succession as if the disclaimant had died prior to the transfer.
         1) The power of the disclaimant to direct redistribution of the property disclaimed, unless limited by an ascertainable standard, even if unexercised, will violate this rule, Treas. Reg. 25.2518-2(e)(1)(i).
         2) The "to a person other than the disclaimant" part of the rule is satisfied so long as no consideration is received by the disclaimant for making the disclaimer and the disclaimant doesn't have any interest in the property after the disclaimer.
            a) Consideration does not have to be that necessary to support a contract. Implied or indirect consideration, even if not legally enforceable, may disqualify the disclaimer, *Monroe Estate v. Commissioner* 104 T.C. 352 (1995).
         3) A major statutory exception to the rule is that if the disclaimant is the surviving spouse of a decedent, then the spouse can retain an interest in the disclaimed property. Treas. Reg. 25.2518-2(e)(2).
            a) Caution: the surviving spouse cannot retain the right to direct redistribution of the disclaimed property in a transfer that is not subject to federal estate or gift tax and that is not limited by an ascertainable standard, i.e. the spouse cannot have a special power of appointment over the property disclaimed, Treas. Reg. 25.2518-2(e)(2).
         4) A disclaimant can retain a fiduciary power to direct the distribution of the disclaimed property that is limited by an ascertainable standard.
            a) Caution: with non-spouses, it is critical that the disclaimant properly disclaim all interests he or she has with respect to the interest in property being disclaimed.
         5) If a disclaimant receives back only a part of the disclaimed property, then the disclaimer only fails as to that part, Treas. Reg. 25.2518-2(e)(3).

C. State Law.

1. A person may disclaim any interest in property that is donatively transferred, by any means including another disclaimer, Section 469.010.
   a. A person making an effective disclaimer is treated as being predeceased for all purposes of determining who receives the property after the disclaimer (Section 469.010).
      i. However, a disclaimer won't:
         1) change the generation level at which a stipital distribution is made, if the disclaimant is the last living person in that generation, Section 469.080; or

        2) disinherit the disclaimant's child or that child's issue born after the disclaimer, to the extent that child or issue has an interest in the disclaimed property after all proper acceleration of future interests have occurred by reason of the disclaimer.
    b. A disclaimed interest does not pass through the disclaimant and is not "subject to the claim of any creditor of the disclaimant."

2. Section 469.020 provides that a disclaimer is made by:
    a. a writing;
    b. which shows an unconditional refusal to accept, in whole or in part, a transfer;
    c. signed by the disclaimant or the disclaimant's legal representative (see Section 469.030.2 for who is a legal representative); and
        i. (a person's attorney-in-fact can be authorized under a Durable Power of Attorney to disclaim interests in property on behalf of that person, Section 404.710.6(4))
    d. delivered on or before nine months after the transfer before any acceptance of the disclaimed interest.
        i. Delivery can be made to:
            1) the transferor;
            2) the transferor's legal representative, including a personal representative; or,
            3) the holder of the legal title to the property to which the interest disclaimed relates.
            4) A disclaimer relating to any matter, including a probate estate, within the jurisdiction of the probate division of the circuit court, may be, but does not have to be, filed in that division.
    e. The right of a person to disclaim cannot be denied by terms of the governing instrument, including a spendthrift clause, 469.020.2

3. Acceptance of the transferred interest precludes a later disclaimer.
    a. Acceptance may be showed by conduct "including acceptance of benefits," Section 469.030.

4. The definition of "interest" for disclaimer purposes.
    a. What can be disclaimed is any interest in property that is donatively transferred, by any means including another disclaimer, Section 469.010.
        i. Note, unlike the old statute governing disclaimers, Section 474.490 *Repealed*, new chapter 469 does not contain a laundry list of interests in property that can be disclaimed. The most important omission is tenancy by the entireties, which was specifically mentioned in the old statute. However, there was not intent to change the law in that respect.
    b. Each separate interest can be independently disclaimed or accepted, Section 469.050.
        i. The term "separate interest" includes, "any specific amount, part fraction, or asset thereof, or formula amount based on present or future facts independent of the disclaimant’s volition..." Section 469.050

c. A power with respect to property is an interest in such property for disclaimer purposes, Section 469.060.
   i. This applies to any power, including a power held in a fiduciary capacity.
      1) However, the power must be "releasable" in order for it to be disclaimed, a test probably not met by most fiduciary powers.
d. Any person who is a potential object of an exercise of a power has an interest in the property subject to the power that can be disclaimed. Section 469.060.
   i. Query, how does this relate to a broad general power of appointment?
e. Any contingent future interest may be disclaimed, Section 469.070.
   i. For purposes of the statute, a "contingent future interest" includes any "vested interest subject to defeasance or divestment," i.e. it does not matter whether the interest is technically "vested" or not.

5. The definition of "transfer" for disclaimer purposes.
   a. There is no broad definition of "transfer" for purposes of determining the nine-month period in which a person may disclaim a transfer of a property interest.
      i. Presumably, other precepts of state law will determine when a "transfer" has occurred from which the time period to disclaim runs.
      ii. Clearly, a transfer that can be revoked by the transferor is not a transfer, 469.040.
      iii. For the disclaimer of future interests, the transfer occurs when the "beneficiaries of the interest have been fully ascertained and their interests vested." Section 469.070.

6. The statutory disclaimer scheme summarized above is not "exclusive."
   a. Case law in effect prior to the effective date of the statute (August 13, 1982) also controls as to whether an effective disclaimer or renunciation was made. For example, see *Commerce Trust Company v. Fast*, 396 S.W.2d 683 (Mo. 1965).

D. Comparison of rules governing disclaimers for tax purposes and for state law purposes.

1. Remember, one of the purposes of Section 2518 was to regularize the disclaimer rules for estate and gift tax purposes and to decrease their reliance on state law requirements.
   a. State law is still relevant in some circumstances.
      i. State law determines the legal character of the interest that is being disclaimed.
         1) See the *Kennedy* case, cited above, where the Circuit court determined that the right to partition joint property was essentially a power of appointment that could be disclaimed.
         2) State law determines the identity of the takers of the interest after a disclaimer.

2. The meaning of "transfer" is broader under the state statutes than under Section 2518.
   a. Essentially Section 2518 begins the nine-month time period at the time of the earliest transfer that is potentially subject to gift or estate tax.

i. State statutes seem to relate the transfer concept to all state laws regarding when a transfer occurs.

b. Under Section 2518, the time limit for disclaiming the transfer of a future interest, such as a remainder interest, runs from the time of the transfer that initially created the future interest, Treas. Reg. Section 25.2518-2(c)(3), while state law clearly starts the nine month period running from the time the future interest becomes a present interest, Section 469.070.

i. For example, assume that A by will creates a trust for the life of B, remainder to B's descendant's, living at B's death, Per Stirpes. To be effective for federal estate tax purposes, B's descendants must disclaim their remainder interest within 9 months from the date of A's death, while for state law purposes, a disclaimer is valid if one of the descendants disclaims such an interest within 9 months of B's death.

III. Selected Post-Mortem Uses of Disclaimers.

A. Estate and Gift Tax Purposes.

1. Funding an under-funded Unified Credit equivalent on death of first spouse.

a. Facts: Jane and John Doe, long time Missouri residents, have assets of approximately $1,300,000. Some time ago, the Does' had a competent estate planning attorney finalize appropriate Wills for each of them that contained a well drafted marital formula intended to place assets with a value equal to the first spouse's remaining Unified Credit equivalent into a common credit shelter trust. John dies in 1999 survived by Jane. Jane now reveals that all of the $1,300,000 assets are titled in joint names, "Jane and John, husband and wife," because "John's barber told him to do that in order to avoid probate." Both of the Does' signatures were required to transfer any of the property prior to John's death. All property had been titled that way for several years prior to John's death.

i. Assuming that Jane has not accepted any benefits of the property, she can disclaim the undivided one-half interest in the tenancy by the entireties property that passes to her on John's death, Treas. Reg. 25.2518-2(c)(4). Thus $650,000 of the Does' assets will pass pursuant to the provisions of John's will and fully fund the credit shelter trust.

ii. Note: to be safe, one-half of each asset should be transferred to John's probate estate and hence into the credit shelter trust.

iii. Upon further investigation it is discovered that (1) Jane spent one-half of the income from the joint brokerage account for two months after John's death, and (2) the provisions of the credit shelter trust provide that upon her death, Jane can direct distribution of property to any person or entity she desires, except herself, her estate, her creditors, or the creditors of her estate.

1) The opportunity to disclaim might not be lost by her acceptance of a portion of the income. Since she was the owner of one-half of the account, she had a right to one-half of the income, and one can characterize the one-half of the income she left in the account as attributable to the one-half of

the account she is disclaiming. PLRs 8637113, 9008034, 8619002, and 9012053.

2) In order for the disclaimer to be effective, Jane must also disclaim the special power of appointment in the credit shelter trust. Treas. Reg. Section 25.2518-2(e)(2).

iv. The 1997 amendment to the Section 2518 regulations made this type of post-mortem planning much easier. Under the old regulations, one had to be worried about which spouse "contributed" the property. More importantly, in this situation, Jane couldn't disclaim because the "transfer" of the Survivor Portion of the property occurred at the time of the creation of the tenancy which was more than 9 months before John's death. Even after AOD 1990-06, in Missouri, it was not clear that Jane could disclaim the Survivorship Portion because tenancies by the entireties are not subject to partition under Missouri law.

b. Facts: John Doe dies in 1999 survived by his spouse, Jane Doe and all of his three children. John has $1,300,000 of assets titled in his sole name, and Jane does not own any assets with significant value. John's Will states that Jane is to receive all of his assets, outright, and in the event Jane fails to survive him, all of the assets pass to the Does' descendants, Per Stirpes.

i. Jane can disclaim her right to receive one-half of the assets under John's Will. The disclaimed share of John's assets will pass pursuant to the terms of the John's Will equally to the Does' three children.

1) John's $650,000 Unified Credit equivalent will be utilized and no estate taxes will be paid on Jane's death (assuming the property retained by Jane doesn't appreciate in value above the Unified Credit equivalent available at Jane's death).

2) The problem is that Jane might not feel comfortable only having $650,000 of assets to live on for the rest of her life.

3) In the meeting with Jane and the children where the disclaimer is being discussed the children assure Jane that she will have "as much as she needs to live on" as gifts from the children for her life.

a) This understanding, if implemented, may invalidate the disclaimer, even thought the promise to gift to Jane is probably not legally enforceable, *Monroe Estate*, supra.

2. Saving or Increasing the Marital Deduction

a. Facts: John Doe dies in 1999 survived by his spouse, Jane Doe and all of his three adult children. John has $2,000,000 of assets titled in his sole name, and Jane does not own any assets with significant value. John does not have a will. Under Section 474.010, Jane will receive $1,010,000 and the three children will share $990,000. An estate tax will be payable, as the taxable estate will be $990,000. The three children want to increase the amount passing to Jane, up to the amount she can receive without causing any estate tax, and they collectively disclaim $340,000 of asset passing to them.

i. This increases the amount passing to Jane only under certain circumstances, because state law might not direct that the disclaimed assets are distributable to Jane.

ii. First, if any of the children have descendants, then that child's disclaimed portion passes to that child's descendants under Section 474.010. Although the descendants can also disclaim their interests, if any of the descendants are minors, then a guardian must be appointed to make the disclaimer, which a descendant can disavow when he or she attains age 21.

iii. See PLRs 8729008, 8514095, and 8409089, and TAM 8701001, for cases where this has been done. TAM 8926001 is a good example where it didn’t work.

b. Facts: John Doe, a long time Missouri resident, has assets of approximately $1,300,000. Some time ago, John had an attorney finalize a revocable trust for him that contains a marital formula intended to place assets with a value equal to his remaining Unified Credit equivalent into a common bypass trust. All the rest of the assets are directed to be distributed to a "Marital Trust" from which his wife, Jane, will receive all income, and principal if needed. Principal of the Marital Trust can also be distributed among the Does' three children, if needed. John dies in 1999 survived by Jane and the three children.

i. The Marital Trust does not qualify for the marital deduction as Qualified Terminable Interest Property under Section 2056(b)(7) because of the power of the trustee to distribute trust principal to the children. The children each execute a disclaimer of their interest in the principal (but not their remainder interests) of the trust. Assuming that all of the other requirements with respect to qualified disclaimers are met, the disclaimer is qualified and the trust will qualify as QTIP.

ii. See PLRs 8815038, 9018046, 9010062, and 8824066 for examples of this type of disclaimer, but see TAM 9818005 where this did not work.

c. A surviving spouse is entitled to a marital deduction for his or her successor interest in a Charitable Remainder Trust under 2056(b)(8), so long as that interest is the only non-charitable interest in the trust. Where another person also has an interest in the trust, a 2056(b)(8) marital deduction can be obtained if the other non-charitable beneficiary disclaims his or her interest, See TAM 873004.

3. Saving a Charitable Deduction.

a. Facts: John Doe, a childless widower, dies with $2,000,000 of assets. His will provides for the establishment of a trust with all income payable to his sister, Jane, for her life with the remainder to the Home for Homeless Cats, a qualified 501(c)(3) charitable organization. Jane has a comfortable pension and is very active in the Home for Homeless Cats. The attorney handling John's estate quickly realizes that none of the estate qualifies for the charitable deduction because the trust is a split interest charitable trust that does not meet the requirements of Section 2055 (e) for the charitable deduction, and is not reformable to meet those requirements under Section 2055(e)(3).

b. If Jane is willing, a disclaimer would accelerate the remainder of the charitable beneficiaries (see *Cavers v. Saint Louis Union Trust Co*. 531 S.W.2d. 526 (Mo. App. 1975)) and all assets passing to the charity would qualify for the charitable deduction under Section 2055(a) as a direct distribution.

4. Using the $1,000,000 Generation-Skipping Transfer Tax Exemption.

a. Facts: John Doe dies survived by his wife, Jane, and three adult children. Each child has one grandchild. John's revocable trust contains a marital formula with a disposition to a trust designed to qualify for the marital deduction as a general power of appointment trust under Section 2056(b)(5). The unified credit equivalent is left to a credit shelter trust of which Jane and all of her descendants are permissible beneficiaries of income or principal. On Jane's death all of the assets pass to John's descendants, Per Stirpes. The value of John's estate is $3,000,000. The three children are successful and prosperous in their own right.

b. It is important to fully conserve John's full $1,000,000 GST exemption for later distribution to the grandchildren. However, any GST exemption over the credit shelter amount will be lost if it passes to the GPOA marital trust, because upon Jane's subsequent death, Jane will become the transferor of the trust assets, Section 2652(a)(1). Assuming that the trust otherwise qualifies as QTIP, Jane can disclaim the general power of appointment in the marital trust so that a QTIP election will have to be made under Section 2056(b)(7) in order to qualify that trust for the marital deduction. The marital trust can then be split under local law (Section 456.520.3(29)) and a reverse QTIP election can be made with respect to that trust under Section 2652(a)(3) to which the remainder of John's GST Exemption (after allocation to the credit shelter trust) will be applied. See PLRs 9048045, 9043055, and 9028005.

c. Another alternative for use of John's GST Exemption is for Jane to disclaim a sufficient portion of the Marital Trust so that the credit shelter trust will be funded with a amount equal to John's GST Exemption, plus an amount necessary to pay estate taxes generated due to the disclaimer. Each of the children could disclaim his or her remainder interest in the credit shelter trust, so that upon the death of Jane, those assets would pass to the grandchildren.

5. Spousal rollover of IRA proceeds.

a. Facts: Assume the same facts as in section 3.1.4.1, above. Assume additionally, that John also has a $1,000,000 IRA, the primary beneficiary of which are the trustees of his revocable trust, and the contingent beneficiary of which is Jane.

b. Because there are plenty of other assets to fully fund John's unified credit equivalent and his full GST Exemption, it is a much better tax planning for Jane to be able to "rollover" the IRA proceeds into her own IRA, and defer the income taxation on the IRA proceeds for a much longer period of time. However, Jane must be the direct recipient of the IRA proceeds to do this. If the Trustees of all trusts established under John's instrument, Jane, and all other trust beneficiaries can disclaim, the IRA proceeds will pass to Jane by the contingent beneficiary designation, and she can rollover the proceeds, See PLR8838075.

i. Such a disclaimer can often be difficult, if not impossible, because of the existence of minor beneficiaries or open classes of beneficiaries, members of which are still unborn or unascertained. ***A better use of disclaimers in IRA planning is to have the spouse be the primary beneficiary with the trustee of the revocable trust as the contingent beneficiary.*** Thus, there is no question that the spouse can roll over the IRA, but if the proceeds are needed in whole or in part to fund a credit shelter or GST disposition, the spouse alone can affect the disclaimer.

B. Non-Tax Disclaimers.

1. Conforming to a decedent's intent.

a. Facts: Jane Doe, a widower, has $1,000,000, three living children, and a Will that states all of her property is to pass at her death equally, free of trust, to her three living children, and, Per Stirpes, to the descendants of any deceased child. Two of the children live out of state, and her daughter, Mary, lives next door to Jane. After Jane's death it is discovered that Jane has placed $500,000 of her assets into a brokerage account titled jointly with Mary, because her hair dresser told her she could avoid probate that way. Either Jane or Mary could access the brokerage account, and Mary has never done so. Mary wants to conform to Jane's intent and have all of Jane's assets pass equally to her and her siblings. Mary does have significant assets of her own and does not want to make any taxable gifts.

i. Mary has several options.

1) First, she can do a series of disclaimers with respect to 2/3rds of the joint account. Note, that since Jane contributed all of the funds to the account and could unilaterally divest Mary of her entire interest in the account, the "transfer" of the account to Mary for disclaimer purposes occurred at Jane's death, Treas. Reg. 25.2518-2(c)(4)(iii). Mary must disclaim both (1) her interest in 2/3rds of the account, and (2) all of the interest she has under Jane's will in the disclaimed portion of the account. This works, unless Jane has descendants, in which case they also must disclaim their interests to have the disclaimed portion of the account pass to Mary's siblings. If some are minors, this raises issues, even if a conservator is appointed and is allowed to make the disclaimer.

2) Second, Mary could disclaim the whole account and have it pass pursuant to Jane's Will to her and her two siblings. For gift and estate tax purposes, the portion of the disclaimer with respect to the portion of the disclaimed property that passes to her will not be "qualified," Treas. Reg. Section 25.2518-2(e)(1)(ii), because the property passes to her. However, Treas. Reg. Section 25.2518-2(e)(3) clearly provides that the disclaimer of that portion of the property that passes to her siblings is qualified. The issue then becomes, whether there is any gift element in the transaction. Mary has made a valid disclaimer of the portion that passes to her under State

law. Thus, there does not seem to be a gift, because the non-qualified portion of the disclaimed property comes back to Mary.

2. Avoidance of Creditors.

a. Facts: John Doe has severe financial problems and is deeply in debt. John's mother, Jane, who was very wealthy, has just died leaving all of her assets to John. Jane's testamentary documents provide that if John predeceased her, then all of her assets are distributable to John's living descendants, Per Stirpes. John has two responsible adult children. John would rather see his children receive the assets than his creditors.

i. John can disclaim his interest in his mother's assets and those assets will pass pursuant to Jane's Will to John's two children. The issue is whether this is a transfer in fraud of John's creditors. Assuming that the disclaimer conformed with the rules in chapter 469, Section 469.010 explicitly provides that "[f]or all purposes the disclaimed interest is deemed to have passed directly from the transferor to the ultimate taker or takers and is not subject to the claim of any creditor of the disclaimant." Although there is no Missouri cases on point, it would seem that (1) a disclaimer is not a "transfer" for state law purposes, and (2) even if it is a transfer, it is exonerated from creditor claims so cannot be fraudulent as to a creditor. There is still an issue as to the application of federal bankruptcy law to valid state disclaimers.

b. Facts: In 1963, a trust was established for the benefit of Jane Doe for her life. Upon her death, the trust directs that the trust estate is to be distributed to Jane's then living descendants, Per Stirpes. Jane dies in 1999, survived by her three children. In 1990, her daughter, Jean, was in a terrible car accident and has been profoundly impaired since that time. Jean has been receiving Medicaid and SSI, which are her sole means of support. John, Jean's brother, is the conservator for Jean. Jean has no descendants.

i. John could apply to the court that supervises Jean's conservatorship and ask for the court to approve a disclaimer by Jean of the share of the trust that Jean has inherited from her mother. Assuming that John's request is approved, and the other requirements of chapter 469 are met, a valid legal disclaimer should be made. First, Section 469.030.2 provides that a conservator can disclaim on behalf of a protectee. Second, with respect to a future interest, the 9-month disclaimer period begins to run when "beneficiaries of the interest have been fully ascertained and their interests vested." This is true whether the future interest is technically "vested" or not. Thus, in this case, the 9 month period for Jean to disclaim the interest she is entitled under the trust begins to run on Jane's death.

1) The Missouri Division of Family Services that administers Medicaid purportedly takes the position that such a disclaimer is a transfer of an "available resource" for Medicaid purposes and can result in a period of ineligibility. The first issue under the statute is whether a DFS is a creditor

of the beneficiary. Second, even if the DFS is not a "creditor," Section 469.010 states that "[f]or all purposes the disclaimed interest is deemed to have passed directly from the transferor to the ultimate taker or takers…" Query, does "for all purposes" somehow not encompass the statutes and regulations regarding Medicaid eligibility? This issue has not been resolved by Missouri courts. For an example of a case where it was held that a disclaimer effectively transferred assets for Medicaid purposes see *Neilsen v. Cass County Social Services Board*, 395 N.W.2d 157 (N.S. 1986). For an example of a case where it was held that a disclaimer did not effectively transfer assets for Medicaid purposes see *State v. Murtha*, 427 A.2d 807 (1980).

2) Note: this disclaimer would not be effective for federal estate and gift tax issues if the assets weren't included in Jane's estate for federal estate tax purposes.

3. Environmental Problems.

a. Facts: John Doe dies survived by two children, who share his estate equally under the provisions of his Will. The Will further provides that if a child had failed to survive John, that child's share passes to his or her descendants, Per Stirpes. If there are no descendants, then all of John's assets pass to Washington University. John has no heirs other than his two children, who each have one child over the age of eighteen. Shortly after John's death, it is discovered (or remembered) that John owns a piece of realty that was formerly a lead paint factory. The company hired to perform the phase one environmental assessment wore containment suits, and the EPA has been calling.

i. Query: If the disclaimers meet the state law requirements and everyone in the chain of distribution disclaims their interests in the property, will the property escheat to the state?

IV. Conclusion

A. The amended Regulations under Section 2518 significantly simplify the rules regarding disclaimers of interest in property titled jointly with right of survivorship. The new rules make it much more likely that uninformed clients who title property in that manner without realizing its estate and gift tax consequences, will not inadvertently generate unnecessary estate and gift tax.

B. The new disclaimer statutes contained in Chapter 469 clarify many points that were unclear under case law and the prior statutes.

C. Disclaimers can be very effective in changing or repairing a decedent's estate plan. However, as one can see from the examples above, both state law impacting disclaimers and federal estate and gift tax laws controlling when disclaimers will be recognized for federal estate and gift tax purposes are complex, and can prevent achieving many goals through the use of a disclaimer.