Are there Tax Consequences if You Disclaim an Interest in Property from a Trust?

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Question: I am the primary beneficiary of a trust set up by my mother and my 2 daughters (ages 27 and 30) are also beneficiaries. The balance of the trust is to be distributed soon and my daughters want to disclaim any interest in it, so it will all go to me. My question is, what are the tax consequences of this arrangement? The total value of the trust is about $250,000. Thank you, L.

Answer: Dear L - You are right in thinking that there may be some adverse tax consequences if your daughters disclaim their share of the trust. Although it is not clear from your question, I am assuming that your daughters acquired a 1/3rd interest in your mother's trust upon your mother's death.

Generally speaking, when a person is designated as the beneficiary of an interest in property under a will or a living trust, the interest vests immediately upon the death of the transferor unless there is some other intervening condition that must be satisfied. The same is true for interests given to designated beneficiaries under retirement plans (including IRAs and 401(k) plans), annuity contracts, and life insurance policies.

There are times, however, when a designated beneficiary doesn't want the interest given to him or her, as is the case with your daughters. People in this situation often think that they can just refuse the interest and that's the end of the story. They feel that way because, in their minds, they haven't actually received anything and, therefore, they don't actually own it.

Unfortunately, the tax laws say otherwise. Once the interest vests in a designated beneficiary, the designated beneficiary is deemed to own it. From that moment on, any refusal or disclaimer of the interest by the designated beneficiary constitutes a gift of the present value of that interest for federal gift tax purposes. The gift is deemed to be made to the contingent beneficiary or beneficiaries designated under the governing instrument; i.e., the will, trust, etc.

If that's the case, then how would anyone ever refuse an inheritance without incurring a gift tax? The short answer is that, for many years, you couldn't. If there was any consolation in the way the tax laws were written, it rested in the fact that the resulting transfer could be offset by the annual gift tax exclusion. Any excess over the annual gift tax exclusion could be sheltered from an actual out-of-pocket tax payment by the unified credit against gift and estate taxes. Even so, it was still a pain because you had to file a gift tax return and you lost all or part of your unified credit against future gift and estate taxes.

In order to correct this problem, Congress amended the tax laws to provide for a qualified disclaimer as part of the Tax Reform Act of 1976. A "qualified disclaimer" allowed an individual to refuse an interest in property without being deemed to have made a gift of the interest. In that case, the individual was treated as though he or she had never received it - so there was no need to file a gift tax return, or to use a part of his or her unified credit, or even pay any gift taxes out-of-pocket.

Still, in order to take advantage of the qualified disclaimer provisions, you have to satisfy the following requirements:

(1) The disclaimer must be in writing.

(2) The disclaimer must be given to the personal representative of the decedent's estate or the trustee of the decedent's trust, or to any other person holding legal title to property to which the interest relates, no later than 9 months after the later of —

(A) the day on which the transfer creating the interest in such person is made, or

(B) the day on which such person attains age 21,

(3) The person making the disclaimer must not have accepted the interest or any of its benefits.

(4) And, as a result of such disclaimer, the interest must pass without any direction on the part of the person making the disclaimer, and passes either —

(A) to the spouse of the decedent, or

(B) to a person other than the person making the disclaimer.

So, Mrs. L, the good news is that your daughters can disclaim their interest in your mother's trust without the transfer constituting a gift to you. However, they will have to meet the requirements set forth above, including the requirement that the disclaimer be made within nine (9) months after the transfer was made to your daughters. I am assuming that is nine (9) months after your mother's death, but there may be other conditions in the trust instrument that actually

delay the vesting of your daughters' interests. For this reason, I would suggest that you consult with an experienced estate planning attorney because these requirements are unforgiving. Once the nine (9) month period has expired, you're simply out of luck.Attorney Michael Pancheri is a practicing attorney and the founder and CEO of the Living Trust Network. You may contact him by email at info@livingtrustnetwork.com. You may also contact him at the Living Trust Network's web site. Its URL is http://www.livingtrustnetwork.com

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