

SUMMARY OF DISCLAIMER TRUST OPTION

Married couples do not *automatically* get two exemptions from the federal estate tax. They must *do something* to get two exemptions. There are basically two ways for married couples to obtain two exemptions (or, to say it another way, to "secure the use of" two exemptions), so that a greater amount can be transferred without triggering estate taxes: (i) fund a "Bypass Trust" on the death of the first spouse and (ii) make the portability election on the death of the first spouse.

The traditional method used by married couples to obtain two exemptions from the federal estate tax was to set up and fund a "Bypass Trust" on the death of the first spouse. If the Wills or Trust instrument created by a married couple give the surviving spouse an *option* to create a Bypass Trust on the first spouse's death, the device used to exercise that option is called a "disclaimer." Wills of that type are usually referred to as "disclaimer Wills" or "optional Bypass Trust Wills." In addition, a Bypass Trust created this way is often called a "Disclaimer Trust." The idea of this estate plan is to allow the surviving spouse to shelter some of the assets owned by the first spouse to die from estate taxes on the surviving spouse's death and also to provide certain other benefits that trusts provide, which outright ownership does not provide (such as creditor protection). Thus, a Disclaimer Trust is a type of Bypass Trust that is created in a different way from a tax formula in a Will or trust instrument that mandates the creation of a Bypass Trust on the first spouse's death. The Disclaimer Trust method is more flexible.

A surviving spouse has 9 months from the date of the first spouse's death to decide whether to forego keeping some or all of the assets the deceased spouse leaves to him/her and, instead, have some or all of those assets pass into the Disclaimer Trust. The surviving spouse can disclaim (renounce) gifts made to him/her on the first spouse's death regardless of the transfer method, i.e., whether those gifts are made in a Will or trust instrument or in a beneficiary designation form. Note that the Internal Revenue Service takes the position that if, after the death of the first spouse and before the 9 month period has ended, the surviving spouse re-titles any assets into his/her individual name, that action by the surviving spouse eliminates the disclaimer option for those re-titled assets. Thus, the surviving spouse should be careful not to accidentally foreclose the disclaimer option by acting too quickly after the death of the first spouse. Nine months is usually sufficient time to make an informed decision regarding the disclaimer option.

Recent law provided a second method that married couples can use to obtain two exemptions from the federal estate tax: portability. Portability can be used with respect to the deceased spouse's assets passing directly (outright) to the surviving spouse. Many couples use both the Disclaimer Trust option AND portability to shelter more assets from estate taxes.

The issue for married couples is whether it is likely that the value of the assets included in the surviving spouse's estate at death will exceed the then applicable estate tax exclusion amount (a/k/a the estate tax exemption amount). If so, the Disclaimer Option may solve that problem. Assets held in a Disclaimer Trust when the surviving spouse dies are *not* includable in the surviving spouse's estate for federal estate tax purposes. However, all other assets, including assets held in a

revocable trust, *are included* in the surviving spouse's estate at death. If the value of the surviving spouse's estate is likely to exceed the exemption in the year of his/her death, then it might be prudent for the surviving spouse to disclaim the maximum amount of "appropriate assets" when the first spouse dies. Certain assets are usually not disclaimed to the Disclaimer Trust, for various reasons. For example, the surviving spouse does not normally disclaim pre-tax retirement plans because of potential adverse income tax consequences. Instead, the portability election can be made to cover those types of assets.

The estate tax exclusion amount for 2024 is \$13,610,000 because of the Tax Cuts and Jobs Act passed in December 2017. That amount represents a basic exclusion amount of \$10 million, with inflation adjustments added to the base amount, calculated from a base year of 2011. Per the law already on the books, the estate tax exclusion amount will revert back to a \$5 million base amount, adjusted for inflation, in 2026.

In addition to the tax savings that can be achieved by use of a Disclaimer Trust, assets held in a Disclaimer Trust are also protected from creditors' claims. One example of a creditor is a tort creditor who sues the surviving spouse for personal injuries sustained in a car accident and is able to obtain a judgment against the surviving spouse. Another potential "creditor" is a new spouse of the surviving spouse or the children of that new spouse. The assets in the Disclaimer Trust are designated to pass to the children of the original couple on the death of the surviving spouse and, thus, the Disclaimer Trust assets cannot be left to a new spouse of the surviving spouse. Further, the children of the new spouse of the surviving spouse will not be successful in making a claim against the assets held in the Disclaimer Trust.