

Disclaimer Trusts in Estate Planning

Estate planning is the catchall phrase commonly used to describe strategies to save state and federal death taxes. Oregon has an inheritance tax on all assets owned at death, with rates ranging from 5.6% to 16%. The Federal Estate Tax rate is 45%, and will soon increase to 55%. Under current law, the first \$1 million of estate assets is exempt from Oregon Inheritance Tax, and the first \$3.5 million of estate assets is exempt from Federal Estate Tax. Each decedent is entitled to his or her own exemption. By structuring how assets are owned, and by signing certain documents (Wills, Trusts, Deeds, etc.), a married couple can maximize use of the available exemptions, and therefore minimize or eliminate any death taxes. The most commonly used strategy at present is a Disclaimer Trust.

What is a Disclaimer?

A disclaimer is simply a waiver by a beneficiary of his or her right to inherit property from a decedent. Upon the death of one spouse, the surviving spouse could deliberately choose to not inherit some or all of the assets from the decedent, by signing a disclaimer. This may be advisable, in order to avoid "over loading" the estate of the surviving spouse, and in order to make full use of the exemption amounts referred to above. A disclaimer may be made any time during the nine months after the death of the first spouse to die. Starting with the date of death, the surviving spouse can not receive any income or other benefits from the assets to be disclaimed.

Creating a Disclaimer Trust

A Disclaimer Trust may be specified in your Will or your Living Trust. It is typically a testamentary trust, which means it becomes active only after you die. The Disclaimer Trust is funded with a portion of your estate assets. The assets which pass into your Disclaimer Trust are those which are disclaimed by your surviving spouse. The Disclaimer Trust effectively "captures" the disclaimed assets, keeping such assets available for use by the surviving spouse, for the remaining life of the surviving spouse. Upon the death of the surviving spouse, all assets in the Disclaimer Trust are typically distributed to your children in equal shares.

Maximizing Use of Exemptions

The strategy of using a Disclaimer Trust is designed to reduce estate taxes on the death of the second spouse to die. In effect, the Disclaimer Trust allows full use of the federal estate tax exemptions available to each spouse, protecting up to \$7 million total, under current federal law. The Disclaimer Trust is also written to make full use of the state inheritance tax exemption, protecting up to \$2 million total, under current state law. This is achieved by allowing the Disclaimer Trust to be divided into two portions. One portion (the "Double Exempt Trust") is limited to the state exemption, currently \$1 million. The other portion (the "State QTIP Trust") is considered part of the Disclaimer Trust for federal estate tax purposes, but is not part of the Disclaimer Trust for

state inheritance tax purposes. Instead, this portion is not subject to state inheritance tax on the death of the first spouse to die, but will be included in the estate of the surviving spouse on his or her death. This result is achieved by the making of a QTIP election (discussed below) for that portion of the Disclaimer Trust in excess of the state inheritance tax exemption amount. Such an election is permitted by an Oregon law intended to create a solution for the difference between the state and federal death tax exemption amounts.

All amounts which are disclaimed will be exempt from state and federal death taxes, up to the above exemption limits. Thus, you will be using the tax exemptions available to the first spouse to die, instead of wasting these exemptions by passing all assets directly to the surviving spouse.

Asset Ownership

The Disclaimer Trust works best if all of your assets are divided into two separate groups of approximately equal size, one owned by husband or his living trust, and one owned by wife or her living trust. It is helpful to prepare a simple chart listing all material assets, and designating which spouse or trust should be the owner. This will help you analyze the division of your assets. Of course, changes in asset ownership sometimes raises complications, and is usually handled over several months or even years.

QTIP Election

The Disclaimer Trust is usually designed to be Qualified Terminable Interest Property (QTIP). To qualify as QTIP property, the surviving spouse must receive at least the income from such property for life, paid in quarterly or more frequent installments. For any or all of the QTIP property, your trustee has the power to choose, during the nine-month period after your death, between (i) allowing the QTIP property or any portion of it to be taxed in your estate, or (ii) making the QTIP election for such property, causing it to be taxed in the estate of the surviving spouse. This creates greater flexibility by allowing a "second look" at the projected death taxes following the death of the first spouse to die. In most cases, it is preferable to postpone the payment of state and federal taxes, and the QTIP election effectively allows this.

Flexibility

Flexibility is critical in estate planning. We cannot know in advance what circumstances will exist when we die. For example, we cannot know the future value of assets, nor the amount of tax exemptions or applicable tax rates. A Disclaimer Trust allows for maximum flexibility and is well suited to our inability to predict changes in the tax laws or the size and composition of your estate.

ADDITIONAL RESOURCES

A person interested in estate planning in order to save state and federal death taxes, should seriously consider use of a Disclaimer Trust. Such a person should consult with a qualified attorney experienced in the use of Disclaimer Trusts and other estate planning strategies, before signing any documents. Numerous articles are published daily by various sources in print and electronically. However, the accuracy of such information is sometimes questionable.



For more information or questions, please contact Steven R. Bennett at 503-228-8588 or by email at srb@pmblaw.com.

Copyright © 2009 Powers McCulloch & Bennett. All Rights Reserved. (Revised 10/18/09)

The contents of this article are intended for general information only and should not be construed as legal advice or opinion on specific facts and circumstances.

Disclaimer pursuant to IRS Circular 230: To the extent that this article concerns tax matters, it is not intended to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law.

Powers, McCulloch & Bennett, LLP

PMB Law is a Portland, Oregon law firm representing and advising individual and business clients throughout Oregon. Our firm was founded in October of 1973 and we have over eighty-five years of combined legal experience. Visit our Web site at www.pmblaw.com for more information about our offerings and ways we can help you.