



Estate Planning / Trust and Estate Litigation Newsletter

January 2005

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A PROFESSIONAL LAW
CORPORATION

*Protecting and Preserving
Wealth for Future
Generations*

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Disclaimer Proves Fatal to Estate Plan

Mr. Katz executed a will in 1991 that called for the creation of a “pecuniary credit shelter trust” equal to the amount of the “aggregate federal estate tax exemption equivalent.” The will language further provided that the credit shelter trust “shall not be reduced on account of any disclaimer by my wife.” Finally, another provision in the will stated that “notwithstanding any otherwise conflicting provision in this will, if my wife disclaims any interest in any portion of the property otherwise passing outright to her under this Article of my will, such portion shall be added to the [credit shelter] trust.” The purpose of the credit shelter trust created under Mr. Katz’s will was to place an amount equal to the amount that can pass free of estate tax into trust so that it would eventually pass to his children without being subject to estate taxes in his wife’s estate.

The effect of a qualified disclaimer is to treat the disposition of the asset disclaimed as if the disclaimant had predeceased, thereby causing the assets to be distributed to the contingent beneficiary under the will, trust, retirement plan, life insurance or other document controlling the disposition of the asset. Where this is no controlling document, the asset would be distributed to the next person of priority under the intestacy laws of the state. Internal Revenue Code section 2518 provides that a qualified disclaimer must (1) identify the property being disclaimed, (2) be in writing, (3) be signed by the disclaimant, (4) be an irrevocable and unqualified refusal to accept the interest in the property, (5) be made within nine months after date of death of the owner of the property, (6) be made prior to the disclaimant’s acceptance of the disclaimed interest or any of its benefits, and (7) the disclaimed interest must pass without any direction on the part of the disclaimant.

Upon Mr. Katz’s death in 1998, the amount that could be passed free of estate tax was \$625,000. Apparently Mrs. Katz felt she had no need to access any of the funds being transferred to the credit shelter trust under her husband’s will, so she disclaimed her interest in the credit shelter trust. This means that the assets allocated to the credit shelter trust would pass immediately to Mr. Katz’s children under the terms of the credit shelter trust.

In addition to disclaiming her interest in the credit shelter trust, Mrs. Katz also disclaimed her interest in a designated number of shares of five different securities owned by her husband. At trial, her lawyer explained that Mrs. Katz's disclaimer of these securities was for the purpose of directing what assets she was disclaiming in association with the funding of the credit shelter trust.

The IRS argued that Mrs. Katz disclaimed both her interest in the \$625,000 allocated to the credit shelter trust as well as her interest in the five securities – therefore an estate tax was due on the value of the securities disclaimed since the value of all assets disclaimed was in excess of the amount that could be passed free of estate tax. The estate argued that Mrs. Katz only intended to disclaim \$625,000 worth of assets.

The Tax Court in *Estate of David Katz v. Commissioner*, T.C. Memo 2004-166, held that the language of the will was clear – the credit shelter trust was to be funded with \$625,000 and any disclaimer by Mrs. Katz was not to reduce this amount, instead any amount disclaimed was to be added to the credit shelter trust. Therefore, the Tax Court held for the IRS.

In this case, the executor of Mr. Katz's will could have allocated the designated securities to the credit shelter trust without an additional disclaimer by Mrs. Katz and the estate tax imposed by the IRS could have been avoided. This is a perfect example of why it is so critically important to hire a specialist in estate planning to assist your clients with their estate and trust administrations. Here, a simple mistake by Mrs. Katz cost her children hundreds of thousands of dollars in estate taxes that would have ultimately been avoided but for the errant disclaimer.

Estate Planning Numbers for 2005

2005 Applicable Exclusion Amount for Estate Tax:	\$1.5 million
2005 Lifetime Gift Tax Exemption Amount:	\$1 million (frozen through 2010)
2005 GST Tax Exemption Amount:	\$1.5 million
2005 Estate, Gift and GST Tax Highest Tax Bracket:	47%
2005 Annual Gift Tax Exclusion Amount:	\$11,000
2005 Annual Non-Citizen Spouse Annual Gift Amount:	\$117,000
2005 IRC § 2032A Special Valuation Limit:	\$850,000
2005 Conservation Easement Limit:	\$500,000 (frozen since 2002)
Taxable income for trust is taxed at 35% rate after:	\$9,750 for 2005
Taxable income for individual is taxed at 35% rate after:	\$326,450 for 2005

Lowest to Highest and Lowest IRC § 7520 Rates for 2004: 3.8% - 5.0%

(The IRC § 7520 Rate is used to value certain split interest gifts such as Qualified Personal Residence Trusts, Grantor Retained Trusts, and Charitable Lead and Remainder Trusts.)

Can We Be of Assistance to Your Clients?

Dennis M. Sandoval, A Professional Law Corporation, specializes in estate planning (including probate administration and trust / will contests), asset protection planning, elder law (including qualifying for Medi-Cal coverage, conservatorships, and creation of Special Needs Trusts for disabled beneficiaries) and tax controversy work (including federal and state tax audits, appeals and litigation). All of your referrals will be handled professionally, and if the client agrees, you will be sent email updates as to the progress in his or her case.

Mr. Sandoval is available to speak to your group or organization. Call (951) 734-9728 to schedule him to speak on any topic relating to estate planning, elder law, asset protection or taxes.

Upcoming Seminar for the General Public			
Subject Matter	Date	Time	Location
Planning for a Lifetime Partnership Under the California Domestic Partnership Right and Responsibilities Act (Estate Planning for Gays and Lesbians)	March 2005	TBD	Janet Goeske Senior Center 5257 Sierra Street Riverside
Long Term Care Planning for the Middle Class	March 2005	TBD	Janet Goeske Senior Center 5257 Sierra Street Riverside
Estate Planning for Unmarried Couples	Summer 2005	TBD	Riverside City College Community / Adult Education
Providing for a Special Needs Child	Summer 2005	TBD	Riverside City College Community / Adult Education
Estate Planning for the Business Owner	Summer 2005	TBD	Riverside City College Community / Adult Education
Asset Protection Planning for Business Owners and Professionals	Summer 2005	TBD	Riverside City College Community / Adult Education

Upcoming Seminars / Classes for Professionals

Planning Traps for Same Sex Partners Under the California Domestic Partner Rights and Responsibilities Act of 2003	2/9/2005	5 – 8 pm	San Bernardino Estate Planning Council University Club University of Redlands
Pitfalls for Gays and the Elderly Under the California Domestic Partner Rights and Responsibilities Act of 2003	4/9/2005	9 am – noon	University of California at Riverside Extension (UNEX) 3 hrs. Attorney CLE CFP / CPA applied for
The Basics of Medi-Cal Planning for Long Term Care	4/30/2005	8 am – 5 pm	UNEX 7.5 hrs. Attorney CLE CFP / CPA applied for
Naming a Trust as Beneficiary of a Retirement Plan; A Magical Mystery Tour; Federal Estate Tax Repeal Update and Recent Developments; Avoiding Malpractice: Using a (d)(4)(A) Trust to Protect Benefits for Disabled Beneficiaries	5/12 – 5/15/2005	TBD	American Academy of Estate Planning Attorneys Eden Roc Resort & Spa Miami
Retirement Plan Distribution Rules: A Magical Mystery Tour; Federal Estate Tax Repeal Update and Recent Tax Developments	5/18 – 5/20/2005	TBD	National; Academy of Elder Law Attorneys Fairmont Hotel San Francisco
The Mechanics of Drafting First Party and Third Party Special Needs Trusts in California	6/18/2005	9am – noon	UNEX 3 hrs. Attorney CLE CFP / CPA applied for
Maintaining and Maximizing Government Benefits for Special Needs Beneficiaries: The Basics of Administering a Special Needs Trust	6/18/2005	1 pm – 4 pm	UNEX 3 hrs. Attorney CLE CFP / CPA applied for
Retirement Plan Distribution Rules: A Magical Mystery Tour	9/29 – 10/2/2005	TBD	National; Academy of Elder Law Attorneys Sheraton New Orleans New Orleans
Topics to be Determined	10/6 – 10/10/2005	TBD	American Academy of Estate Planning Attorneys Catamaran Hotel San Diego