

Estate Planning

Flexible estate planning: Disclaimer trusts and the Clayton QTIP election.

By Scott Garrison, JD

An important tenet of estate planning is that situations are always subject to change. The best estate plans will offer flexibility to enable family members to modify a plan when faced with changed circumstances. This becomes particularly important when Congress makes major modifications to tax laws, as recently occurred in late 2017.

In particular, trust arrangements that are regularly employed in estate planning deserve a second look to address such legislative changes and offer the opportunity to adapt to any future tax law changes.

Rather than adhering to complicated plans with complex structures, estate planners can add flexibility and simplicity and achieve tax advantages by utilizing qualified disclaimer trust planning and the Clayton QTIP election.

What is a disclaimer?

A disclaimer is a refusal to accept property or assets passing by gift or bequest, as under a will or similar document. For federal gift tax purposes, a disclaimer of property will not be treated as a taxable gift by the disclaimant (i.e., the individual disclaiming the property) to the individual or entity to whom the property passes if the disclaimer meets the following requirements:

1. The disclaimer is in writing;
2. It is made within nine months of the latter of (a) the day on which the transfer creating the interest in such person is made (generally, the date of death of date of gift), or (b) the day on which the disclaimant attains age 21;



3. The disclaimant has not accepted any of the benefits of the disclaimed property; and
4. As a result of the disclaimer, the interest passes without any direction on the part of the disclaimant and passes either (a) to the spouse of the decedent, or (b) to a person other than the disclaimant.

A disclaimer meeting all foregoing requirements is known as a “qualified disclaimer” pursuant to §2518 of the Internal Revenue Code.

How are disclaimers used in trust planning?

Qualified disclaimers can establish a “wait and see” approach to determine what is most suitable for a family based on state and federal estate laws, creditor protection concerns, and overall estate distribution objectives. A disclaimer by the

surviving spouse can utilize the tax exemptions of the first spouse, remove subsequent growth from the taxable estate, and provide creditor protection if desired. Conversely, if circumstances warrant, the survivor may choose to accept a bequest to obtain maximum control and flexibility over the subsequent distribution of the estate. Additionally, the survivor may still be able to utilize the estate tax exemption of the first spouse under a concept known as exemption portability. This approach gives the surviving spouse maximum flexibility in terms of whether a disclaimer trust should be created, and if so, the extent to which the trust should be funded.

When would it be beneficial to utilize a “Clayton” QTIP election?

A qualified terminable interest property (QTIP) trust enables the

grantor of the trust to provide for a surviving spouse and maintain control of how trust assets will be distributed once the surviving spouse passes away. Income generated from the trust is given to the surviving spouse to ensure that the spouse is taken care of for the rest of his or her life. Some of the requirements for a QTIP trust include that:

1. The surviving spouse is the sole lifetime beneficiary of the trust;
2. All income must be distributed to the surviving spouse every year at a specified interval; and
3. No person has a power during the surviving spouse's life to appoint any part of the property to any person other than to the surviving spouse. Additionally, the deceased spouse's executor must make an election to treat all or a specified portion of the trust property as qualified terminable interest property.

One of the benefits of the QTIP trust is that trust assets receive a step up in basis at the survivor's death, enabling heirs to avoid capital gains taxes. If

estate tax exemption portability is available, estate taxes can be reduced or eliminated as well.

The Clayton QTIP approach, first authorized in *Estate of Clayton*, 976 F.2d 1486 (5th Cir. 1992), and later accepted by the IRS in Treas. Reg. 25-2518-2(e)(5), Example 5, is a variation on the conventional testamentary QTIP trust which can add additional flexibility in anticipation of future tax law changes. Rather than vesting the power solely with the surviving spouse (as under the disclaimer option), the Clayton QTIP gives the decedent's executor or personal representative the discretion to determine how much of the estate should pass to a QTIP, based on an assessment of assets and the tax landscape. The portion not elected to pass to the QTIP trust then passes to a non-marital trust share also established for the survivor's lifetime benefit.

The Clayton QTIP approach may have some slight advantages over using a disclaimer trust. With the Clayton election there is no danger of waiving the disclaimer by the

surviving spouse's acceptance of the property, and there is no problem with giving the surviving spouse a power of appointment over the remainder interest, as there is in a disclaimer trust.

Additionally, the decision to make the Clayton QTIP election is typically made by an independent personal representative, avoiding any gift tax exposure to the surviving spouse, and placing the decision making in the hands of a third party to account for a blended family situation.

Conclusion

While tax laws may change and fluctuate with any given congressional cycle, it is important to remember that many conventional planning techniques may prove to be a workable solution to provide for estate planning flexibility. Conventional marital trust planning devices, such as using qualified disclaimers and the Clayton QTIP election, may help to determine the best course of action regardless of whatever future tax law changes occur.



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