Drafting opportunities under the new Texas disclaimer statute

Glenn M. Karisch
Austin, Texas
The materials

The paper

• **Most of our focus will be on the new drafting section of the paper on pages 31 - 45**
  - There’s a lot of information in the rest of the paper

Appendix 1

• The statutory text with section-by-section commentary

Appendix 2 and texasprobate.com

• Forms

These slides are available at texasprobate.com

• Click “Papers and Articles” under “Information for Professionals”
MS Word versions of the forms at 
texasprobate.com

1. Disclaimer of interest in a decedent’s estate where a personal representative has been appointed
   a. Mailed
      i. Full disclaimer
      ii. Disclaimer of interest in specific asset
      iii. Formula disclaimer
   b. Hand Delivered
      i. Full disclaimer
      ii. Disclaimer of interest in specific asset
      iii. Formula disclaimer

2. Disclaimer of interest in a decedent’s estate where no personal representative has been appointed
   a. Full disclaimer
   b. Disclaimer of interest in specific asset

3. Disclaimer of interest by a trustee
   a. Trustee’s notice of intent to disclaim
   b. Waiver of trustee’s notice of intent to disclaim
Introduction

The old law:
• Estates Code Chapter 122
• Trust Code Section 112.010

The new law:
• Texas Uniform Disclaimer of Property Interests Act: Property Code Chapter 240
There’s no state law time limit

- Since 1977, Texas disclaimer laws had a 9-month deadline
  - Modeled after gift tax law, but it wasn’t a perfect match

- The new law is de-coupled from tax law

- The new deadline: disclaimers are permitted prior to acceptance
  - Taking possession of the interest, or
  - Exercising dominion and control over the interest
But don’t ignore the tax deadline

- The 9-month deadline for gift tax purposes still applies
  - A person disclaiming after the 9-month deadline could be making a taxable gift
  - But gift tax issues affect only a small fraction of the population

- The Texas Act contains a tax savings provision
  - If it is a valid disclaimer for gift tax purposes, it automatically meets the Texas requirements
Eliminating 9-month deadline enhances the use of disclaimers for creditor protection

- **The new law preserves the relation-back doctrine**
  - Dyer v. Eckols, later codified: A disclaimer relates back to the time of death or irrevocable transfer

- **Pre-petition disclaimers work in bankruptcy**
  - Matter of Simpson (5th Circuit 1994)

- **Post-petition disclaimers don’t work**
  - In re Schmidt (Bkrtcy W. D. Tex. 2007)

- **Disclaimers for Medicaid purposes don’t work**
Fiduciary disclaimers

• Court approval is required for:
  o Disclaimers by dependent administrators and guardians
  o Disclaimers by trustees of court-created trusts
  o A disclaimer that would result in property or an interest in property passing to the fiduciary personally

• Court approval is not required for disclaimers by:
  o Independent executors
  o Agents under powers of attorney
  o A natural guardian (a/k/a parent) of a minor if the minor would have received the disclaimed property only as a result of another disclaimer
  o Trustees of non-court-created trusts, but...
Trustee disclaimers

- New (or at least clarified): a trustee may disclaim, keeping property from passing into the trust.
- The trustee must either:
  - Give 30 days’ notice to beneficiaries; or
  - Get court approval.
- If court approval is not obtained, the disclaimer “must be compatible with the trustee’s fiduciary obligations”:
  - Concerned about liability? Get court approval.
  - Concerned about saving money/complexity? Give notices.
The mechanics of making a disclaimer

- Only one notice
  - No need to deliver notice to executor and file with court
  - The statute clearly states to whom the notice must be delivered for each type of property
    - Possible trap: It is possible that disclaimers must be sent to multiple persons

- Special mailbox rule
  - If mailed to intended recipient at good address by certified mail, delivery is considered to have occurred on the date of mailing regardless of receipt
Texas Uniform Disclaimer of Property Interests Act:
Effective date: September 1, 2015
Operative date: December 1, 2014

Option: Disclaim under old law or wait to disclaim under new law

Old law applies | New law applies
We will cover these four topics:

• Drafting estate planning documents in anticipation of possible disclaimers
• Drafting disclaimers themselves
• Drafting notices and waivers for trustees wishing to disclaim
• Drafting pleadings and related documents for court approval of disclaimers

Drafting opportunities

pp. 31 - 45
Drafting EP docs with disclaimers in mind

pp. 31 - 32

- **An old dog: disclaimer into the bypass trust**
  - Supplementing a formula funding clause
  - A “disclaimer trust”

- **A new trick: disclaimer out of the bypass trust**
  - A way to get basis adjustment at the second death
  - It works “downstream,” but probably not “upstream”
  - **Solution:** have an express provision addressing disclaimers by the trustee of the bypass trust in every case
Drafting EP docs with disclaimers in mind

pp. 32 - 33

- Going crazy: directing disclaimers into and out of all trusts
  - Trustee disclaimer from bypass to QTIP, and vice versa
  - If trustees of bypass and QTIP both disclaim, property goes outright to surviving spouse
  - Trustee disclaimer from GST-exempt trust to non-exempt trust
  - Disclaimer into a special needs trust
  - Disclaimer into a QSST or ESBT
  - Disclaimer of retirement benefits into conduit trust
  - Disclaimer of retirement benefits out of conduit trust
Drafting EP docs with disclaimers in mind

pp. 33 - 34

• Consider using a special trustee to make disclaimers to avoid court approval
  o Court approval is required if a trustee disclaimer causes property or an interest in property to pass to the trustee individually
  o A disinterested special trustee with the power to disclaim solves this
    • Must be a “trustee,” not a trust protector or advisor
    • As a trustee, the special trustee will be subject to fiduciary duties but may be exculpated to the extent permitted by Trust Code
  o May a family member with an interest in the trust have the power to appoint a special trustee?
Drafting EP docs with disclaimers in mind

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• Should the trustee be exculpated for making disclaimer decisions?
  o The limits on exculpation in the Trust Code apply
  o This should not be a boilerplate provision

• Consider prohibiting trustee disclaimers
  o This must be done in the instrument creating the fiduciary relationship
  • A pour-over will cannot prohibit a disclaimer by the trustee of an inter vivos trust
Drafting EP docs with disclaimers in mind

pp. 35 – 36

• Using a disclaimer to make a defined-value gift
  o The gift instrument directs the property back to the donor or into a QTIP for the donor’s spouse to the extent the donee disclaims
  o The donee makes a formula disclaimer
  o The Wandry case permits defined-value gifts without resorting to a disclaimer

• Using a disclaimer to defer the decision to pay gift tax or estate tax
  o May be useful if the donor believes the 2704 regulations are coming out in the next nine months
  o The donee has nine months to choose to make transfer subject to gift tax or estate tax
  o Does the IRS have a pre-arranged plan argument? (see the Monroe case, 5th Cir. 1997)
Drafting disclaimers

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• See the paper for an extensive discussion (pp. 12 - 18)
• See the forms (Appendix 2, texasprobate.com)
• Make sure the disclaimer is delivered to the proper person
Using the notice provisions for trustee disclaimers

pp. 36 – 38

• Who is entitled to notice?
  o Current beneficiaries
  o Presumptive remainder beneficiaries
    • “... in the absence of notice to the trustee of the exercise of the power of appointment...”
    • Revocable versus irrevocable exercise of a power of appointment
  o Minor or incapacitated beneficiaries
    • Court-appointed guardian or conservator
    • Minor with no court-appointed guardian or conservator: to a parent
  o Notice to the Attorney General if a charity is a beneficiary
    • AG notice is not required merely because a charity is:
      o A permissive object of an unexercised power of appointment or
      o A remote contingent beneficiary
Using the notice provisions for trustee disclaimers

pp. 38 – 41

• Exceptions to the notice requirement
  o A known beneficiary who cannot be located after reasonable diligence; an unknown beneficiary
    • There is no requirement for an ad litem or notice by publication
  o A descendant of a beneficiary “to whom the trustee has given notice” if the beneficiary receiving notice virtually represents the descendant
  o A beneficiary who waives the notice requirement
    • A form of waiver is included in Appendix 2

• See the notice examples, pp. 39 – 41
Using the notice provisions for trustee disclaimers

**pp. 38 – 41**

- **Be aware of these traps when using waivers**
  - Notices still may be required even if all adult beneficiaries and charities sign waivers
    - Notice must be given to the ancestor virtually representing his or her descendants - a waiver by the ancestor is insufficient
    - Notice must be given to a parent of a minor child - a waiver by the parent is insufficient
    - Notice must be given to the Attorney General if a charity is involved - a waiver by the Attorney General is insufficient
    - **Best practice: Don’t wait until the last minute.** The 30-day notice requirement could frustrate the plan even if waivers are anticipated
  - Use extreme caution about including a release in the waiver
    - A release supported by consideration may be considered an acceptance of benefits, disqualifying the disclaimer for tax purposes, or be evidence of a pre-arranged plan (see the Monroe case)
Using the notice provisions for trustee disclaimers

p. 41

• The notice must contain specific statements
  o It must state that the trustee “intends to disclaim,” but a trustee giving notice is not obligated to disclaim
  o It must specify “the earliest date the trustee intends to make the disclaimer”
  o It must include statements about the disclaimer’s effect and the beneficiaries’ rights

• Other disclosures may be required, even though the Disclaimer Act doesn’t say so
  o A disclaimer is probably a material fact affecting the beneficiary’s rights

• The notice must be “given not later than the 30th day before the date the disclaimer is made”

• The form of a notice is included in Appendix 2
Using the notice provisions for trustee disclaimers

pp. 41 – 42

- Notice must be sent by personal delivery, first-class mail, facsimile, e-mail, or any other method likely to result in the notice’s receipt
- When may the trustee disclaim?
  - The trustee may not disclaim before the earliest date specified in the notice
  - The trustee may not disclaim before the 30th day after the notice is “given”
    - Is notice “given” when sent or when received? – Use personal delivery, fax or email to eliminate this issue
  - Best practice:
    - The “earliest date” in the notice should be 30 days after notice is sent
    - The trustee should not disclaim until 30 days after notice is received by the beneficiary
Using the notice provisions for trustee disclaimers

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• What should a beneficiary opposed to the disclaimer do when receiving a notice?
  o A beneficiary does not lose his or her right, “if any,” to sue the trustee for breach of fiduciary obligations
    • This suit may occur after the disclaimer
    • After the disclaimer, it cannot be undone based on breach of fiduciary duty
  o The statute does not state a mechanism for objecting to the disclaimer
    • Giving the trustee notice of objection does not prevent the trustee from disclaiming
    • Filing a suit before the disclaimer and seeking injunctive relief is the only way to stop the disclaimer if the trustee is determined to make it
Seeking court approval of fiduciary disclaimers

pp. 43 – 45

• Necessary parties
  o The Disclaimer Act doesn’t specify necessary parties, so the necessary party rules for the type of fiduciary apply. For example, Tex. Trust Code § 115.011 applies to trusts.

• Forum
  o The Disclaimer Act doesn’t specify the jurisdiction of courts to hear actions related to disclaimers, so the jurisdiction rules applicable to different types of fiduciaries apply.

• Judgment
  o Should the fiduciary agree to the terms of the judgment? Preferably not, but it probably does not present an acceptance of benefits problem.
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Austin, Texas