

Disclaimer of Beneficial Interest and the Silent Trust

Take-Away: A silent trust will prevent the trust beneficiary from making a *qualified disclaimer* for transfer tax purposes.

Background: Michigan now has a statute that permits a trust to be *silent*, thus relieving the trustee of its fiduciary duties to keep the trust beneficiaries informed about their interests in the trust.[MCL 700.7409a.] This statute refers to a *nondisclosed trust*, but for convenience it is referred to as a *silent trust*. If the trust instrument relieves the trustee of the duty to keep trust beneficiaries reasonably informed about the administration of the trust and of material facts necessary for them to protect their interests in the trust [MCL 700.7814(1)], what is a trustee's fiduciary duty, if any, when it comes to informing the trust beneficiary of his/her right to make a disclaimer? If the trust beneficiary is kept in the dark about his/her interest in the trust, how can the trust beneficiary exercise his/her ability to disclaim their beneficial interest in the trust, or more importantly, the beneficiary's ability to make a *qualified* disclaimer that does not result in a taxable gift by the beneficiary? [IRC 2518.]

Trust Code: MCL 700.7814(b)(2) mandates that a trustee keeps qualified trust beneficiaries reasonable informed about the administration of the trust and of the material facts necessary for the beneficiaries to protect their interests. This duty includes promptly furnishing to the trust beneficiary copies of the terms of the trust that describe or affect the trust beneficiary's interest in the trust, and relevant information about the trust property. In addition, this duty also requires the trustee to notify the trust beneficiaries of the existence of the trust, the identity of the settlor, and their right to request a copy of the terms of the trust that describe or affect the beneficiary's interest in the trust. With this information, the trust beneficiary would then, presumably, have enough information upon which to decide whether to disclaim a portion or all his/her interest in the trust. It is this fiduciary duty to furnish critical information about the trust to the trust beneficiary that is eliminated when the settlor chooses to adopt a *silent* trust. [MCL 700.7409(a)(1)(a)(i).]MCL 700.7409(a)(1)(a)(i).]

Duty to Advise of Disclaimer Right: Apparently, implicit in the trustee's fiduciary duty to keep trust beneficiaries informed about the trust and their interests in the trust, is also the

duty to inform trust beneficiaries of their right to disclaim their interest in the trust. Google reports:

In general, a trustee has a duty to inform beneficiaries about the trust and its administration, which includes advising beneficiaries of their right to disclaim a beneficiary interest in the trust. This duty is rooted in fiduciary principles, ensuring beneficiaries are aware of their rights and can make informed decisions about the trust.

Unfortunately, there is no legal citation to support Google's report of the trustee's duty to inform a trust beneficiary of his/her right to disclaim his/her interest in the trust, but it makes sense- a beneficiary needs to know that they have an interest in the trust, along with what assets are held in the trust, before he/she can exercise his/her right to disclaim that beneficial interest. Consequently, a trustee's duty should include the obligation to keep trust beneficiaries informed about the trust, its administration, and the scope of the beneficiary's interest in the trust, in order for that beneficiary to be able to "protect his or her interests" which presumably would also include advising the trust beneficiary of his/her right to disclaim that interest. A *silent* trust prevents the trust beneficiary from exercising his/her ability to *timely* disclaim all or part of his/her *disclaimable interest* in the trust.

Taxable Gift: While a disclaimer can be made by the *silent* trust beneficiary after he/she finally learns of his/her interest in the trust in the future, that disclaimer will result in **taxable gift** by the disclaiming beneficiary if their disclaimer occurs more than 9 months after their beneficial interest in the trust was created (unless the beneficiary was a minor, in which case the right to make a qualified disclaimer is extended to attaining age 21.)

In sum, a *silent trust* denies the trust beneficiary of his/her right and ability to make a *qualified*, i.e., gift tax-free, *disclaimer*.

Disclaimable Interest: EPIC defines a *disclaimable interest* to include but is not limited to, property, the right to receive or control property, and a power of appointment. However, a *disclaimable interest* does not include an interest retained by or conferred upon the disclaimant by the disclaimant at the creation of the interest. The survivorship interest in joint property is not considered to be an interest retained or conferred upon the disclaimant even if the disclaimant created joint property. [MCL 700.2901(2)(b).] A person

to whom a *disclaimable interest* devolves, like a trust beneficiary, may disclaim the *disclaimable interest*, in whole or in part.[MCL 700.2902(1).] This right of a trust beneficiary to disclaim exists notwithstanding the existence of a spendthrift provision that limits the interest of the disclaimant, or a restriction or limitation contained in the trust instrument on the right to disclaim. [MCL 700.2902(2)(a).]

Qualified Disclaimers: Michigan's statute describing what is required for a *valid* disclaimer parallels the federal law on what is required for a *qualified disclaimer* for federal gift tax exclusion purposes. [IRC 2518.] [MCL 700.2903.] The big difference, though, is that Michigan does not impose a time limit on when the disclaimer can occur, while the Tax Code requires that the disclaimer occur within 9 months of its creation (unless the disclaimant is under the age of 21 years.)

Conditions: A *qualified disclaimer* under the Tax Code requires that the disclaimer must: (i) be **irrevocable** and unqualified; (ii) be in **writing**; (iii) be **delivered** to the person within the time limits for it to be a *qualified disclaimer*- 9 months; (iv) the disclaimant must **not have accepted the interest** disclaimed or any of its benefits; and (v) the interest disclaimed must pass to either the spouse of the decedent or to a person other than the disclaimant **without any direction by the disclaimant**. [Regulation 25.2518-2.] The **writing** requirement means that the disclaimer must identify the interest in the property disclaimed and signed either by the disclaimant or by the disclaimant's legal representative. The writing must be **delivered** to the transferor of the interest, the transferor's legal representative, the holder of the legal title to the property to which the interest relates, e.g., the trustee, or the person who is in possession of the property.

Time Constraint: The **disclaimer deadline** is no later than the date which is **9 months after the later of (a) the date on which the transfer creating the interest in the disclaimant is made, OR (b) the date on which the disclaimant attains age 21**. If the disclaimer is *qualified*, the disclaimant is not treated as having made a taxable gift.

Conclusion: When a settlor expresses interest in creating a *silent* trust, he/she should be alerted to the fact that the trust beneficiary will be unable to make a *qualified disclaimer*. Nor would it be a big surprise when the *silent* beneficiary finally learns of the existence of the trust, he/she might also complain that the trustee prevented them from exercising their

right to *timely* make a *qualified disclaimer*. If the settlor is long-dead when that happens, it will come as no surprise that the beneficiary will blame the trustee for that lost opportunity.

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