

Qualified Disclaimers

Take-Away: A disclaimer is a highly flexible tool that can be used in estate planning to adjust the distribution of assets by gift or inheritance. However, there is not a complete consistency between the Tax Code's requirements and the Michigan Disclaimer of Property Interests statutory requirements. In short, both need to be consulted if the goal is to make a qualified disclaimer.

Background: A disclaimer is a decision by a donee, a beneficiary, or a fiduciary, to either add, or remove, a right or power 'after the fact.' Under the Tax Code and state law, a qualified disclaimer acts as an irrevocable refusal to accept a property interest that, if properly and timely made, is treated as if the disclaimant never received the interest, and the disclaimed property then passes as if the disclaimant had predeceased the transfer. A *qualified* disclaimer does not result in any transfer tax liability to the disclaimant if the decision is made within 9 months of when the interest is created. If the disclaimer is not made within 9 months, or it does not satisfy all the conditions for it to be treated as a disclaimer, then the decision results in a taxable gift by the disclaimant.

Qualified Disclaimers: IRC 2518 describes a *qualified* disclaimer. To be *qualified*, the disclaimer must be made within nine months of the transfer that creates the interest, or the disclaimant-beneficiary's 21st birthday (if later.) The disclaimer must be in writing and be *delivered* to the transferor or the legal representative, e.g., the trustee if a beneficiary is disclaiming his/her interest in the trust. Equally important, the disclaimant must *not have accepted* any benefit of the disclaimed interest.

There is one important exception to the 'non-acceptance' requirement. A spouse can disclaim an interest conferred by their spouse and still retain a limited interest in the disclaimed property under IRC 2518.

Example: Back when folks were more worried about the federal estate tax, a marital deduction trust was sometimes drafted with a disclaimer by the surviving spouse in mind. The assets that passed to the marital trust, if appreciating, could expose the surviving spouse's estate to federal estate taxes caused by that future appreciation. In anticipation

of this concern, the surviving spouse could (or would) disclaim some, or all, of those appreciating assets that would otherwise pass to the marital trust. The survivor's disclaimer would cause the disclaimed property to pass to a Disclaimer Trust, where the spouse would be the lifetime income beneficiary of that Disclaimer Trust. Thus, the qualified disclaimer would remove the appreciating assets from the survivor's taxable estate, but he/she would still have access to the income generated by the disclaimed assets. If the disclaimed assets passed instead to the credit shelter or Bypass Trust, the disclaimer would not be qualified if the surviving spouse, as beneficiary of the Bypass Trust, had the right to withdraw 5% of the Bypass Trust assets each year- that would have resulted in a taxable gift by the survivor of the disclaimed assets. Thus, when there was disclaimer-planning for the surviving spouse, the disclaimed assets had to pass to a separate Disclaimer Trust, and not to the conventional Bypass Trust. These days, with a \$15 million applicable exemption amount, and the *portability* election, the focus is more on a basis 'step-up' on the surviving spouse's death, so there might be less of a reason for a surviving spouse to disclaim appreciating assets away from his/her gross estate to a Disclaimer Trust.

Michigan Disclaimer Statute: Michigan's Disclaimer of Property Interests is located in the Estates and Protected Individual's Code (EPIC.) [MCL 700.2901-2912.] There are, however, some 'tricky' interpretations regarding disclaimers under Michigan's statute that dictate when an interest cannot be disclaimed if the interest is one that was conferred or retained by the disclaimant. A few examples follow.

Example 1: Claude conveys a life estate in real estate to his nephew Ned, with Claude retaining a remainder interest in the real estate. Claude cannot disclaim his remainder interest in the real estate that he had conveyed.

Example 2: Claude conveys real estate to himself and his sister Betty as joint tenants with full rights of survivorship. Claude can disclaim his interest in the jointly owned real estate. Claude is not treated as having retained or conferred the survivorship interest to himself.

Example 3: This same limitation pertains to a right to control. Assume that Claude creates an irrevocable trust. In that trust Claude retains the right to remove and replace the trustee. Claude cannot disclaim the retained right to remove and replace the trustee.

Example 4: If the trust that Claude had created gave his sister Betty the right to remove or replace the trustee, Betty could disclaim that removal and appointment power. [Going down into this ‘rabbit hole’ even further, the Michigan Powers of Appointment Act [MCL 556.112, provides that in some situations the right/power to remove and replace a trustee may rise to the level of a power to designate the transferees of property, which falls within the definition of a power of appointment, which can be *released* [not *disclaimed*] and thus cause federal gift tax consequences arising from that *release*.]

Example 5: The trust instrument contains a restriction and limitation on the ability of its beneficiary, Claude, to disclaim his beneficial interest in the trust. Claude may still disclaim his interest in the trust. [MCL 700.2902(2)(b).]

Example 6: A trustee can disclaim a fiduciary power even if there is a restriction or limitation on the right to disclaim contained in the trust instrument. [MCL 700.2902(3).]

Contents of a Disclaimer: Michigan’s statute provides that a disclaimer is not valid unless it complies with *all* of the following:

- (i) it is in writing.
- (ii) it declares it to be a disclaimer.
- (iii) it describes the disclaimed interest.
- (iv) it is signed by the disclaimant; and
- (v) it is delivered consistent other provisions of the Act, e.g., a beneficiary’s disclaimer is delivered to the trustee. [MCL 700.2903(1).]

If a trustee or fiduciary makes the disclaimer, the disclaimer must be signed by *all* incumbent fiduciaries, unless the governing instrument expressly provides to the contrary. [MCL 700.2903(2).]

A valid disclaimer binds all persons who would claim through the disclaimant. [MCL 700.2902(1).] A disclaimer acts as a nonacceptance of the disclaimed interest, not a transfer of the disclaimed interest, and the disclaimant is treated as never having received the disclaimed interest. [MCL 700.2909(2).] Michigan's statute also abolishes the common law right of disclaimer or renunciation; it is intended to be the exclusive method for a disclaimer. [MCL 700.2911.]

Yet even more may be required for the disclaimer to be valid by Michigan courts than just facially complying with the requirements of the disclaimer statute. For example, in *In re Herbert Irrevocable Family Trust, Michigan Court of Appeals, No. 367338 (April 30, 2025)*, an agreement signed by trust beneficiaries claimed that was a partial qualified disclaimer that was consistent with both IRC 2518 and MCL 700.2903. However, both the probate court and the Michigan Court of Appeals found that the agreement was an invalid disclaimer, despite claiming to have satisfied the statutory requirements of MCL 700.2903, because that agreement did not comply with (i) MCL 700.2909(2) regarding who is bound by the disclaimer, and (ii) MCL 700.2910(1) which identifies when a right to disclaim property is barred. The agreement in question was viewed by the courts as an *acceptance* of property and a sharing of sales proceeds. The Court concluded that the agreement by the trust beneficiaries was a 'failed attempt to modify a trust.'

IRC 2518 and Michigan's Disclaimer Statute: What may come as a surprise to many, Michigan's disclaimer statute does not exactly parallel the rules under IRC 2518. The introductory Comments to Part 9 of EPIC note that:

"It is the intent of Part 9 [Michigan's disclaimer rules] to permit a disclaimer in all instances in which the Internal Revenue Code and the Treasury Regulations permit a 'qualified disclaimer' within the meaning of IRC 2518. In addition, this legislation permits disclaimers in many instances in which the disclaimer would not constitute a 'qualified disclaimer' under IRC 2518. For example, may a devisee in the will of the testator who is still living disclaim that devise before the testator's death? The committee concluded that the disclaimer must be perfected (i.e., delivered) after the death of the testator. It is not clear under the Internal Revenue Code and Treasury Regulations whether one may make a qualified disclaimer before the testator dies. This is one instance in which this legislation may be narrower than the Internal Revenue Code."

A later Reporter's Comment under MCL 700.2910 also notes:

"The Reporter's Comment that introduces this Part 9 clearly indicates the drafters' (and legislative) intent that Michigan disclaimer law departs in significant respects from the federal disclaimer provisions in IRC 2518. Thus, it is unfortunate (and misleading) that the court of appeals in Soloman v Milmet (In re Estee of Milmet), No. 303304 (Mich Ct App Aug 7, 2012)(unpublished) suggested that Section 2910(2) bars a disclaimer that would not be a qualified disclaimer under IRC 2518. State and federal disclaimer laws are not wholly congruent."

Key Point: The import of these Comments is that a valid disclaimer under Michigan's disclaimer statute can nonetheless result in a taxable gift under the Tax Code.

Disclaimer is Barred: Or consider that EPIC identifies when a right to disclaim is *barred* after the event that gives rise to the right to disclaim and before the disclaimer is 'perfected.' Those events identified in the statute are:

- (i) an assignment, conveyance, encumbrance, pledge or transfer of the property, or a contract for such a transaction.
- (ii) a written waiver of the right to disclaim.
- (iii) an acceptance of the disclaimable interest or a benefit under the disclaimable interest after actual knowledge that a property right has been conferred.
- (iv) a sale of the property under judicial sale; and
- (v) the expiration of the applicable perpetuities period. [MCL 700.2910(1).]

Michigan's statute also states that "The right to disclaim is *barred* to the extent provided by *other applicable law*." An act that bars the right to disclaim a present interest in joint property does *not* bar the right to disclaim a future interest in the joint property, [MCL 700.2910(2).] Yet the Reporter's Comments to this section notes: "*State and federal disclaimer laws are not wholly congruent. While a qualified disclaimer under IRC 2518 always will be valid under Part 9, a valid disclaimer under Part 9 could fail to satisfy IRC 2518. Specifically, IRC 2518 is not an 'applicable law' to which reference is made in the first*

sentence of section 2910(2). There is no bar to a valid disclaimer under Part 9 solely because the action would not be ‘qualified’ under IRC 2518.”

Conclusion: If the goal is to make a qualified disclaimer and thus avoid the disclaimer as being treated as a taxable gift, both IRC 2518 and the Michigan Disclaimer of Property Act need to be consulted. In particular, it is important to understand that the Michigan ‘disclaimer of property interests’ law has its own definitions that need to be understood and carefully used in a disclaimer instrument. A disclaimer can be an effective tool to alter who benefits from a lifetime gift or a beneficial interest in trust. A disclaimer can also be used to avoid future federal transfer taxes, e.g., disclaiming a testamentary general power of appointment over trust assets. What is important is to follow the requirements of *both* IRC 2518 and Michigan’s Act and not assume that they are identical in their requirements.

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