MEMO

To: UDPIA Drafting Committee
From: William P. LaPiana
Subject: Draft for October 1998 meeting
Date: May 8, 2012

The style committee made minor changes of organization and language which have been incorporated into the draft.

There are several problems that still exist which I will discuss in section order.

Sections 3 and 4

Several persons commenting on the draft have expressed reservations about the provision for the passing of the disclaimed interest to the descendants of the disclaimant and have questioned the abandonment of the old (and universal rule) that the disclaimant was deemed to predecease the decedent. In effect, the draft creates a lapse statute for disclaimed interests, passing them to a disclaimant's descendants. The advantage of this provision over the traditional language is clearest when the disclaimed interest is a present interest. In such cases, parents are almost always disclaiming so that their children (or perhaps grandchildren) can take the interest the parent would otherwise acquire. (*Examples 1, 1a, and 2 to* **Section 3.**)The language of the draft succinctly expresses that result and eliminates the complex provision necessary to prevent the disclaimer from resulting in a recalculation of the size of shares determined by representation. (*Example 3 to* **Section 3.**) Where there are no descendants of the disclaimant who survive the decedent, the old rule (disclaimant deemed to predecease) is preserved.

Matters are more complicated when the disclaimer is of a future interest. I repeat here the relevant section of the memorandum circulated in March which discussed these problems:

"Assume the following situation (which is quite realistic):

"Example 1: Father's will creates a QTIP trust for Mother which provides that on her death the remainder is to be distributed to their descendants by representation. Father is survived by Mother and by Son and Daughter. Son has one child (GC1) and Daughter has two (GC2 and GC3). Son decides that he wants to make a tax qualified disclaimer of his share of the remainder and he does so within nine months of Father's death. This is a disclaimer of a future interest. Assuming Father's will makes no provision for disclaimed interests, under § 3(3) the disclaimed interest passes to Son's descendants who survive the date of distribution; in this case, Mother's death. Mother then dies and GC1 will take ½ the remainder and Daughter the other half.

"The problem arises in the following situation:

"Example 1a: Assume the same facts as *Example 1*, with the additional fact that Daughter and Son die before Mother. Son's child will still take Son's ½, even though had there been no disclaimer the three grandchildren would have taken the remainder in equal shares (1/3 each). Thus in the situation where Son has only one child, the disclaimer will have the effect of insuring that Son's descendants receive one-half the remainder, even though had Son and Daughter actually died before Mother, GC1, GC2, and GC3 would each have taken 1/3 of the remainder.

"In essence, Son's disclaimer transforms the gift to descendants into a class gift to children. The Draft gives the same effect to the disclaimer that UPC § 2-707 (the future interest lapse provision) gives to the death of a member of a single generation class.

"Under slightly different circumstances, the rule of Section 3(3) could work to the disadvantage of the disclaimant's descendants.

"Example 2: Assume the facts of *Example 1 except* Son has two children (GC1 and GC2) and Daughter has one (GC3). At Mother's death, with both Son and Daughter surviving, GC1 and GC2 take ½ the remainder and Daughter the other ½.

"Example 2a: Assume the facts of *Example 2 except* that Son and Daughter both die before Mother. At Mother's death, GC1 and GC2 share ½ the remainder (the disclaimed interest) and GC3 takes the other ½, even though had the disclaimer not been made, GC1, GC2 and GC3 would each have taken 1/3 of the remainder.

"Whether or not this result should be characterized as undesirable "manipulation is not entirely clear. Unless the order of deaths can be predicted (which could be possible where, for instance, both Son and Daughter in the previous example are terminally ill and likely to predecease Mother) the disclaimer simply creates a risk of "manipulation. In essence, if the disclaimant disclaims solely to "freeze his descendants' share of the remainder he or she is gambling on who is going to die when and how many descendants they will each have at the time the remainder takes effect in possession and enjoyment. UPC § 2-801(d)(1) and (2) have the same effect. Indeed, the *Comment* (as revised in 1993) states that the purpose of the 1993 amendment dealing with the manipulation problem (adding language to make it clear that the disclaimed interest passed only to the disclaimant's descendants) was to insure that in a situation like that described in *Example 1a,* Son's disclaimer did not reduce GC1's share of the remainder. The *Comment*, however, discusses a disclaimer of an intestate share and not the disclaimer of a future interest before the date of distribution. The language of the draft, therefore, does what current law does, insure that the disclaimed interest passes as a result of the disclaimer. The separation of the rules for present and future interests simply highlights a problem that was always there.

"A consistent rule that a disclaimer always causes the disclaimed interest to pass is indeed consistent and makes the result of disclaimers predictable and uniform. This conclusion, of course, makes it clear that the "disclaimed interest in the future interest situation is what the disclaimant would have taken at the date of distribution. The disclaimer does not simply mean that the disclaimant is deemed to be dead at some specific time. In the *Examples* above the disclaimer results in passing ½ of the remainder to Son's descendants. The subsequent event that is ignored is the possible death of both Daughter and Son which under the representation scheme would require equal division of the remainder at the grandchildren's generation. Had Son survived to the date of distribution, he would have taken ½ the remainder so allowing his disclaimer to insure that his descendants receive ½ is not an outlandish result.

"Unfortunately, one can easily imagine situations in which the result is less obvious:

"Example 3: Father's will creates a trust for Daughter, income to her for life and on her death remainder to her descendants by representation. Daughter has two children, A and B. A disclaims. Daughter has another child C. Daughter dies, survived by A, A's two children, GC1 and GC2, B and C. Do GC1 and GC2 take ½ or 1/3 of the remainder? The correct answer, presumably, is one-third, what their parent A would have taken had A survived to the date of distribution and not disclaimed, not the ½ that was A's presumptive share at the time of the disclaimer.

"Example 3a: Assume the same situation as in *Example 3, except* B has three children, GC3, GC4 and GC5 and C has two children, GC6 and GC7. Daughter is survived by A, GC1, GC2, GC3, GC4, GC5, GC6 and GC7, both B and C having predeceased her. GC1 and GC2 should each take 1/6 of the remainder and the other grandchildren each take 2/15 (1/5 x 2/3). Here, A has bettered her children's position by insuring that they take her 1/3 rather than sharing equally with their 5 cousins. Had A simply been deemed to have predeceased the date of distribution, then each of the grandchildren of Daughter would each have taken 1/7 of the remainder.

"Again, the disclaimer converts the gift to descendants into a class gift to children with respect to A and gives the same result as UPC § 2-707.

On reconsideration, I believe that the analogies in the above examples to UPC § 2-707 are not as helpful as I believed in March. Section 2-707 does not apply its antilapse rule for future interests to class gifts in the form of gifts to heirs, descendants, issue and similar language since such gifts have their own lapse provisions. Rather, implicit in the draft is a definition of a disclaimed future interest as the interest the disclaimant would have taken had the disclaimant survived the date of distribution. Again, as *Example 2a* illustrates, a disclaimer of a future interest will have the effect of "freezing the disclaimed interest by making irrelevant the subsequent death of the disclaimant prior to the date of distribution.

Another potential problem involves the disclaimer of an income interest. Under the deemed to predecease rule, a disclaimer by a sole income beneficiary would end the income interest and cause the remainder to accelerate, thus terminating the trust.

Example 4: Mother's will creates a testamentary trust, income to Son for life, remainder the son's descendants by representation. Son disclaims. Under the deemed to predecease rule, he has died before Mother, and the trust will terminate and be distributed to his descendants by representation. Under the draft, the disclaimed interest will pass to his descendants by representation, who then will presumably have an estate *pur autre vie*, enjoying the income for Son's life. At the time I completed the draft that was read in Cleveland, I believed that the language I had used in Section 3(2) and (3) and Section 4(2) and (3) making the passing of the disclaimed interest to descendants subject to the acceleration rule of Sections 3(4) and 4(4) prevented this result. I now agree that the "except as otherwise provided language makes no sense since 3(4) and (4) have nothing to do with the passing of the disclaimed interest. However, I still believe that the acceleration rule prevents the income interest passing to the descendants in *Example 4* and results in acceleration of the remainders and termination of the trust.

The first question is whether that is the meaning of the language. The second question is whether that is the right result. There are problems with the passing of the income interest. If the disclaimer results in the income interest passing to the disclaimant's descendants, it is more difficult to use a disclaimer to correct drafting errors. There can be instances, for example, when the income interest must be destroyed; for example, where someone other than the surviving spouse has an income interest in a trust which must be qualified for the marital deduction. Under the passing to descendants rule, the descendants would also have to disclaim in order to insure the destruction of the income interest. Some of them may be minors and a disclaimer would require court proceedings. Another problem is what happens as multiple holders of the estate *pur autre vie* die. In *Example 4* assume that at the time of his disclaimer, Son's descendants are three children who have three children of their own (one child each). One of the children predeceases Son. Do the two surviving children share the entire income or does the deceased child's children take their parent's share? Where an income interest in a class has been created, courts can apply the class gift rule (surviving class members take), imply cross remainders in each child (same result), or decide that the descendants of the deceased class member take his or share. An example of the latter result is *Dewire v. Haveles*, 404 Mass. 274, 534 N.E.2d 782 (1989) where the court decided that the testator's intention (the case involved a testamentary trust) should provide the answer and gave the deceased class member's income to his child. Where the class members have receive their interest only because of the disclaimer (that is, they are not otherwise income beneficiaries of the trust) it is difficult to imagine that the creator of the trust had any intention for the situation. All he or she created was an income interest in a single individual.

In sum the question is: Should an income interest be subject to the passing to descendants

rule, and if it should not, does the acceleration rule prevent passing?

Section 5 Disclaimer of Survivorship Rights in Jointly Held Property

I made a serious omission in drafting Section 5. Section 5(1) does allow all disclaimers which the Code recognizes as qualified disclaimers with one exception. Under Reg. §25.2518-2(c)(4)(ii), a surviving spouse who is a non-citizen may disclaim more than what the decedent would have received on severance. For joint tenancies and tenancies by the entireties in real property created after July 14, 1988 the "old rules of §2515 apply which provide that on death the deceased donor spouse's gross estate includes all of the property attributable to his or her contribution to the joint arrangement. The surviving non-citizen spouse may therefore disclaim the entire interest included in the deceased spouse's estate. I have tried to redraft Section 5(1) to reflect this rule by allowing a disclaimer of "the greater of what would be received on severance or that part of the property attributable to the deceased holder's contribution.

Section 10 When Disclaimer Barred of Limited

There was discussion of this section at the annual meeting along the following lines:

First, there was discussion of the partial disclaimer of powers. I believe that consensus of the Committee that an exercise of a power that does not exhaust it does not bar subsequent exercise of the power. I have changed §10(b) to try to express that.

Second, there was concern about the effect of a barred disclaimer. A disclaimer that fails under the IRC simply results in a gift, but what is the effect of a disclaimer barred under the Act? Should it take effect as a transfer (a gift) or not? Suggesting that the answer should be yes, I have added a new subsection (d) to §10.

Third, there was a question about what to do with the written waiver of §10(a)(4). In other words, should it be delivered or filed? The written waiver language comes from the 1975 Act and the Comment shows clearly why the Act does not require that anything be done with the waiver:

"It may be necessary or advisable to sell real estate in a decedent's estate before the expiration of the period permitted for disclaimer. In such case, the possibility of a disclaimer being filed within the period could be a deterrent to sale and delivery of good title. [This section authorizes a waiver which will] thus avoid any delay in the completion of a sale or other disposition of estate assets.

Clearly, the idea was that someone would ask for the waiver, making a delivery requirement

superfluous. I suggest that is still good reasoning.

Section 11. Recording of Disclaimer.

There was concern about the use of "may be so filed . . . etc. I believe that the section properly reminds practitioners to consider filing or recording where appropriate. Changing "may to "shall would require recording in instances was the law does not "require but "permits (if there are any such provisions) and would change substantive law.