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A Brief Guide to Qualified Disclaimers for Retirement Plan Administrators

by William D. Jewett on September 16, 2024

A “qualified disclaimer” is a tax-effective way to refuse a transfer of property that would otherwise occur on someone’s death. From time to time, retirement plan administrators may be contacted by a beneficiary who wants a deceased participant’s benefit to go to a contingent beneficiary or the participant’s estate. The way to make that happen is a qualified disclaimer.

Suppose a plan administrator is contacted by a participant’s family shortly after the participant’s death. The participant had completed the plan’s beneficiary designation form naming one of her children as primary beneficiary and her other child as contingent beneficiary. The children are certain their parent intended for each to be a 50% primary beneficiary. The beneficiary designation cannot be modified to capture that intent, because beneficiary designations become irrevocable at the participant’s death. If the children want to carry out what they believe to be their parent’s wishes, does one child have to receive the entire interest and pay taxes on it before giving half of it to the other? Yes – unless the primary beneficiary makes a qualified disclaimer with respect to 50% of the interest, leaving that portion of the benefit to pass directly to the contingent beneficiary.

The requirements for making a qualified disclaimer are set out in Internal Revenue Code section 2518. While this section is found in the part of the tax code that contains the gift tax rules, a qualified disclaimer is generally effective for shifting the burden of income taxes since a qualified disclaimer must result in the property passing directly to another person under applicable state law. To make a qualified disclaimer, four requirements must be met:

1. The refusal to accept the interest must be in writing.
2. The refusal must result in the interest passing to someone else under applicable law.
3. The person refusing the transfer must not have accepted it, including, for example, by cashing a check or by directing the interest to a specific recipient.
4. The written refusal must be received by the transferor of the interest not later than nine months after the date of the transfer or the date the person refusing reaches age 21.

In the case of a retirement plan beneficiary, the last requirement means the beneficiary would generally have to submit a written refusal to the plan administrator not later than 9 months after the participant's death, which is when the transfer is deemed to have occurred.

It may seem unusual for a beneficiary to refuse a deceased participant's benefit, but consider the following scenarios. Suppose a primary beneficiary whose children are named as contingent beneficiaries considers that the assets would eventually reach the children in any case and decides it is preferable for the assets to be taxed now at the lower rate applicable to the children. Or suppose a primary beneficiary with another family member or a trust named as contingent beneficiary is the potential target of a legal claim and is seeking to empty his deep pockets while keeping assets close by. Or suppose a participant and the participant's spouse decide to name the spouse as primary beneficiary with a trust as contingent beneficiary, to give the spouse a choice at the participant's death whether to accept the assets or to have them go into the trust, whichever is most advantageous at the time. In each scenario, a qualified disclaimer might be used, and a retirement plan administrator receiving a purported disclaimer would need to know what to do with it.

A retirement plan administrator who receives a purported disclaimer or an inquiry from a beneficiary regarding a potential disclaimer should take two steps right away. The first step is to note the date the disclaimer is received, to ensure that any deadlines based on the date of death are not missed due to inaction on the plan administrator's part. The second step is to contact legal counsel to determine whether the disclaimer is effective under applicable law and whether the plan would need to be amended to allow the administrator to honor a qualified disclaimer. If a disclaimer is found not to be effective, the disclaimant should be informed promptly and advised to seek separate legal counsel. If it is found to be effective, and if the plan's provisions permit qualified disclaimers, the plan administrator can direct the plan's recordkeeper to proceed as if the disclaimant never had a right to the disclaimed interest.

If you have questions about the effect of qualified disclaimers in the context of retirement plans, please contact a member of our Employee Benefits & Executive Compensation Group.

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