

August 20, 2010

T&E Litigation Update: *Breakiron v. Gudonis*

In *Breakiron v. Gudonis*, Case No. 09-10427-RWZ, 2010 U.S. Dist. LEXIS 80888 (Aug. 10, 2010), the United States District Court for the District of Massachusetts addressed issues concerning the disclaimer of an interest in a trust.

The plaintiff's parents established two qualified personal residence trusts (QPRT) for their one-half interests in their Nantucket property. At the expiration of the ten-year term of the QPRTs, the property passed to the plaintiff and his sister as tenants in common. The plaintiff then consulted with an attorney about the proper way to transfer his interest to his sister while incurring the lowest possible transfer tax. The attorney told the plaintiff to disclaim his interest in the QPRTs, incorrectly advising him that the disclaimers would be valid if executed within nine months after the expiration of the term of the QPRTs, rather than within nine months after the creation of the QPRTs.

Upon learning that the disclaimers were ineffective to avoid the imposition of a gift tax on the transfer, the plaintiff filed suit to rescind his disclaimers. The federal government argued in opposition that the gift tax became due and owing once the invalid disclaimers were executed and that rescission would not relieve the plaintiff of his obligation to pay the gift tax.

The court held that the plaintiff was entitled to rescind the disclaimers, because his execution of the disclaimers was based on his mistaken belief that they would allow him to achieve his intended goal of minimizing taxes. Accordingly, the court reformed the disclaimers "nunc pro tunc," treating them as if they had never been executed and thus treating the gift as if it had never been made. Whether this reformation of the disclaimers would relieve the plaintiff of his gift tax liability presented a more complicated question. After discussing at length the division of authority on this issue, the court held that reformation of the disclaimers is conclusive for federal tax purposes.