Crummey Powers Historical Background

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LORMAN EDUCATION SERVICES
January 2017

Crummey Powers and Estate Planning

Introduction: Crummey Powers

Internal Revenue Code § 2503(b) affords taxpayers an incremental method to reduce their gross estate for federal estate tax purposes by making annual exclusion gifts. A special problem develops when a taxpayer wishes to make annual exclusion gifts in trust. The rules require that, to qualify for an annual exclusion gift, the gift must be of a "present interest." Structurally, a gift in trust is a gift of a "future interest" that would not otherwise qualify for the annual exclusion from federal gift tax. Without something more, taxpayers would be unable to make gifts in trust for their beneficiaries without triggering a gift tax or a reduction in their lifetime estate tax exemption. With the *Crummey* case,[1] the Ninth Circuit Court of Appeals upheld a planning technique that allows taxpayers to make gifts into trust that qualify as a "present interest" and thus are entitled to the annual exclusion.

The Crummey technique provides taxpayers with a method to reduce their gross estate for federal estate tax purposes through a series of inter vivos transfers of wealth that meet the requirements for a nontaxable gift.[2] Trusts that utilize the Crummey technique (sometimes called Crummey trusts) allow taxpayers to maintain control over their gifts to beneficiaries (through the provisions contained in the trust instrument) while also qualifying the gift as a "present interest" in order to realize the benefit of the annual exclusion.[3]

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[1]*Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968).

[2]Charlotte M. Wilson, *The Crummey Power Inter Vivo Trusts: An Analysis of Estate, Gift and Income Tax Consequences to the Trust Beneficiary*, 22 MEM. ST. U. L. REV. 297, 305 (1992).

[3]Patrick T. Neil, *Bare'ly Legal: The Evolution of Naked Crummey Powers and A Call for Reform*, 30 FLA. ST. U. L. REV. 923, 930-931 (2003).

Historical Background

To truly appreciate the implications of Crummey powers and the IRS' vigilance toward protecting the estate tax through enforcing the gift tax, a basic understanding of the federal estate and gift taxes is useful. Faced with the daunting task of funding the Civil War, Congress imposed a variety of new taxes. In 1861, Secretary of the Treasury, Salmon P. Chase, recommended an inheritance tax to Congress. Subsequently, in 1862 Congress enacted an inheritance tax that applied only to transfers of personal property (rates were graduated according to the relationship between beneficiary and decedent and were in proportion to the amount of the beneficiary's share). Later during the war, the inheritance tax was extended to transfers of real property and rates were increased. This first federal inheritance tax was repealed in 1870 when no longer necessary to raise wartime revenues.[4]

After the Civil War, for a short period of time, personal property received by gift or inheritance was treated as income subject to the income tax. However, in 1895 the income tax was held to be unconstitutional.[5] In 1898, a mixed estate and inheritance tax passed Congress which survived Supreme Court review, but was repealed by Congress in 1902.[6]

In 1916, Congress passed the federal estate tax driven by two primary concerns: the necessity to raise revenue and to attack undue concentrations of wealth accumulated through inheritance. The constitutionality of the estate tax was upheld in *New York Trust Company v.*

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[4] Paul R. McDaniel, James R. Repetti and Paul L. Caron, *Federal Wealth Transfer Taxation*, 4th Ed., Foundation Press, New York, 1999, at 3.
[5] *Pollack v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895)
[6] John K. McNulty, *Federal Estate and Gift Taxation*, 3, West Publishing Co. (1994).

Eisner,[7] where the Supreme Court held the estate tax was an indirect tax, i.e., an excise tax, not requiring apportionment among the states.[8]

As soon as the estate tax became law, wealthy persons sought to avoid its provisions by transferring their property via gift before death. Congress was unsuccessful in its attempts to apply the estate tax to such transfers, because of an unfavorable attitude in the United States Supreme Court. Due to the difficulty of applying the estate tax to inter vivos gift transfers, and because Republicans wished to reduce the surtax rates for the top income brackets, Congress enacted the gift tax.[9]

The Revenue Act of 1924 applied to all gifts made after June 2, 1924. This gift tax, however, was repealed effective as of January 1, 1926. Instead, Congress added a provision to the estate tax that all gifts made within two years before death were presumed to be gifts made in contemplation of death and, therefore, includable in the decedent's gross estate. The Supreme Court held this provision unconstitutional in 1932[10] and in anticipation of such a ruling, Congress enacted another gift tax in the Revenue Act of 1932.[11]

In practice, the federal gift tax was established to provide a "safety net" for the federal estate tax.[12] To prevent taxpayers from depleting their estates prior to death, thereby considerably reducing their estate tax liability, the gift tax, subject to certain limitations, imposes a tax upon all transfers of gifts whether direct or indirect and whether the property is real, personal, tangible or intangible.[13]

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[7] 256 U.S. 345 (1921)
[8] McNulty, *supra* note 6, at 3.
[9] McDaniel, *supra* note 4, at 5.
[10] *Heiner v. Donnan*, 285 U.S. 312 (1932)
[11] *Id*.
[12] *Dickman v. Comm'r*, 465 U.S. 330, 338 (1984) (holding that one of the major purposes of the federal gift tax is to protect the estate tax and the income tax).
[13] Neil, *supra* note 3, at 925.