



Crummey Powers and Estate Planning: Case Law

Prepared by:
Todd Denison
Phelps Dunbar LLP

LORMAN[®]

Published on www.lorman.com - June 2021

Crummey Powers and Estate Planning: Case Law, ©2021 Lorman Education Services. All Rights Reserved.



Lorman Education Services is a leading provider of online professional learning, serving individuals and teams seeking training and CE credits. Whether you're looking for professional continuing education or an enterprise-wide learning and development solution, you will find what you need in Lorman's growing library of resources.

Lorman helps professionals meet their needs with more than 100 live training sessions each month and a growing collection of over 13,000 ondemand courses and resources developed by noted industry experts and professionals.

Learn more about Lorman's individual programs, economical All-Access Pass, and Enterprise Packages:

www.lorman.com

Crummey v. Commissioner: Analysis

The *Crummey* case turned on an interpretation of the definitions of “future interest” and “present interest.” The taxpayers in *Crummey* created a trust for the benefit of their four grandchildren. The operative feature in the trust instrument provided that each of the four beneficiaries of the trust could demand, at any time up until December 31 of a given year, up to \$4,000 or the amount transferred into the trust during such year, whichever was less. What distinguished the *Crummey* case from other cases was that the demand power granted to the beneficiaries did not continue for the life of the trust, but rather lapsed at the end of each year it was given. To protect the annual exclusions the taxpayers had taken on their gift tax return pursuant to the trust gifts, they had to show evidence that the minor beneficiaries of a trust could have effectively demanded whatever trust property they were entitled to (thus meeting the definition of a present interest).¹ In order to do so, the taxpayers in *Crummey* relied on the trust language that provided the beneficiaries a right to demand immediate distribution of certain trust funds within a specified period of time, arguing that such a withdrawal right effectively qualified the gifts as present interest.² The IRS countered that the likelihood of the beneficiaries’ exercising a demand right and the intent of the trust settlor in granting the power should be considered when determining whether a gift is of a present or future interest.

The court held that the rights provided in the *Crummey* trust instrument, which granted a power of withdrawal over contributions did qualify such contributions as gifts of a present interest eligible for the annual exclusion. The court noted that the right of withdrawal present in the *Crummey* trust gave the beneficiaries an unrestricted right to the immediate use,

¹ Michael J. Savinelli, *Three Strikes and the IRS is Out?: Crummey, Cristofani, and Kohlsaat: Firmly Entrenched Crummey Powers*, 12 QUINNIPIAC PROB. L. J. 67, 69-70 (1997)

² Neil, *supra* note 3, at 934.

possession and enjoyment of the property contributed to the trust. Further, the court noted that the right of withdrawal need not be exercised in order for the beneficiaries to have a present interest in property contributed to the trust.³ Essentially, the withdrawal power formed the basis for a judicially created “present interest.”⁴

Moreover, the Ninth Circuit expressly declined to entertain the IRS argument concerning settlors’ intent or the likelihood of beneficiaries exercising their power. Instead, the court noted the inconsistency and unfairness to the taxpayer that could result from the IRS implementing such an approach due to the arbitrary nature of trying to interpret the subjective intent behind each decision to allow a demand power to lapse.⁵

The legacy of the *Crummey* case is that taxpayers were afforded a mechanism by which to make a gift to trust for a beneficiary maintain some control over the funds in trust via the language in the trust instrument and still claim the transfer under the annual exclusion.⁶ Although the *Crummey* case can be seen as having served an important and justifiable policy/tax goal, it has also provided estate planners with a broad method whereby the gift tax can be avoided and gross estates for estate tax purposes can be incrementally reduced. Ultimately, *Crummey* has become an effective estate planning tool affording taxpayers the ability to legally and systematically deplete the value of their estates while avoiding transfer tax consequences.⁷

³ James Spallino, Jr., *Drafting and Administering Irrevocable Life Insurance Trusts: The basics and Beyond*, 20 OHIO PROB. L. J. 91, 95 (2009).

⁴ Wilson, *supra* note 2, at 301.

⁵ Neil, *supra* note 3, at 936.

⁶ *Id.* at 937.

⁷ *Id.*

II. Expanding Crummey Powers: *Cristofani v. Commissioner*

The Tax Court decision in *Cristofani v. Commissioner* followed not only the *Crummey* decision but also supported the widespread use of Crummey powers as a trust planning device.⁸ The issue in the *Cristofani* case was the propriety of annual exclusions taken for gifts made in trust to the grantor's two children and five grandchildren, all of whom were minors. The two children and five grandchildren were each given a lapsing power to demand up to \$10,000 from the trust income in the year it was contributed. *Cristofani's* key issue featured the two children of the grantor named as primary beneficiaries of the trust and the five grandchildren retained contingent remainder interests in the trust (the five grandchildren's interests would vest only if their parent failed to outlive the grantor by 120 days).⁹

In *Cristofani*, the IRS attacked the notion the contingent remainder beneficiaries held a present interest because it was not certain that their interest would ever vest, and they would have no interest in the trust if their parents survived the settlor. The Tax Court, however, disagreed with the IRS and, siding with the taxpayers, found the demand power held by each of the grandchildren was indeed a present interest and, therefore, subject to the annual exclusion. According to the Tax Court, the key factor for determining a present interest is whether the beneficiaries are able, in a legal sense, to exercise their right to withdraw the trust corpus and the trustee's right to resist that demand.¹⁰

The *Cristofani* trust document explicitly authorized the right of withdrawal by the five grandchildren. Although the grandchildren never exercised such right, the key legal right to do so was still present and hence they received a gift of a present interest. Accordingly, the gift tax exclusions were

⁸ Savinelli, *supra* note 27, at 71.

⁹ Neil, *supra* note 3, at 941.

¹⁰ Savinelli, *supra* note 27, at 71.

allowed for all five grandchildren. The unanimous *Cristofani* decision not only accepted the use of Crummey powers, but also expanded such use.¹¹

Cristofani allows taxpayers to increase the amount that can be conveyed to a trust gift tax free by increasing the number of beneficiaries that are granted Crummey powers. With *Cristofani*, the Tax Court has approved the use of a trust in which contingent beneficiaries possess Crummey powers as an effective method to increase the availability of the annual exclusion from estate and gift taxes. Although the IRS acquiesced in the result of the *Cristofani* case, it did not concur with the Court's broad interpretation of the annual exclusion and indicated that it would challenge the validity of Crummey rights where a beneficiary had no current or vested remainder interest in the trust or where there was a prearranged understanding that the withdrawal rights would not be exercised. However, the IRS has not been successful in advocating this position.¹² The IRS approach with Crummey powers distinguishes between vested and contingent beneficiaries. The IRS believes, as to contingent beneficiaries, the grant of a Crummey power may be merely a cohesive device to gain extended annual exclusions with no meaningful present interest transferred to the contingent beneficiary.¹³ Some commentators have noted the *Cristofani* decision expanded the class of eligible Crummey beneficiaries far beyond what was contemplated by the Ninth Circuit.¹⁴ Affording a grantor the opportunity to take advantage of the annual exclusion in a situation where the beneficiary of the Crummey power has little or no opportunity to receive a share of the trust corpus (other than the annual withdrawal power), and thus little or no reason for allowing the power to lapse, is a subversion of

¹¹ *Id.*

¹² Duncan E. Osborne and Elizabeth Morgan Schurig, *Domestic Asset Protection*, DOM. & INT'L L. & TACTICS § 14:32.

¹³ James C. Magner, Linda R. Getzen and Edward F. Koren, *Preparation and Use of Trusts*, 2 EST. TAX & PERS. FIN. PLAN. § 19:58 (2011).

¹⁴ Neil, *supra* note 3, at 941.

both the policy rationale behind *Crummey* and the general purpose of allowing an annual exclusion in the first place.¹⁵

III. Types of Crummey Powers

Crummey and *Cristofani* demonstrate two of the three varieties of Crummey powers: basic Crummey powers, naked Crummey powers and semi-naked Crummey powers. A basic Crummey power (in favor of a trust beneficiary) is given to a trust beneficiary who has an interest in the corpus of the trust. A naked Crummey power is a lapsing demand right on the part of a trust beneficiary without any corresponding interest in the corpus of the trust.¹⁶ A semi-naked Crummey power is given to a beneficiary whose interest in the trust corpus, external to their Crummey power, is contingent upon the occurrence of some uncertain future event.¹⁷

From the beginning, the Service has attempted to place limits on the expansion of the class of beneficiaries eligible to hold Crummey powers. Generally, the Service recognizes the validity of Crummey powers for beneficiaries who hold a current income interest or vested remainder interest in the trust, provided there is no pre-existing understanding between the grantor and the beneficiaries concerning the exercise of their withdrawal rights.¹⁸

In Technical Advice Memorandum 87-27 0003 (March 16, 1987), the Service indicated that a naked Crummey power would not qualify the subject property for the annual gift tax exclusion. It follows that the trust settlor must give a trust beneficiary an interest in the trust in addition to the Crummey power in order to qualify any gifts to the trust for the annual gift tax exclusion.¹⁹ A policy rationale for the Service's hostility toward

¹⁵ Neil, *supra* note 3, at 944.

¹⁶ *Id.* at 938.

¹⁷ *Id.*

¹⁸ Sebastian v. Grassi, Jr., *Income, Gift, and Estate Tax Aspects of Crummey Powers After the 2001 Tax Act, Part I*, PROB. & PROP. 37, 38, (2004). See *infra*, Section XII (discussing informal agreements for waiver).

¹⁹ Wilson, *supra* note 2, at 311.

naked Crummey powers is that with naked Crummey powers, the beneficiary has no conceivable economic incentive to allow a lapse to occur because once the demand power has lapsed, the income from that demand right is gone forever.²⁰

A common characteristic of estate planners is a willingness to “push the envelope” when applying methods such as Crummey powers. The attempt to qualify semi-naked Crummey powers is representative of this characteristic. Semi-naked Crummey powers involve beneficiaries who are contingent remainder beneficiaries and remotely contingent beneficiaries. The Service generally will not contest a gift tax annual exclusion for transfers subject to a Crummey power when such power is held by a current income beneficiary or a vested remainder beneficiary because such beneficiaries have current or long-term beneficial interests in the trust and in the value of the corpus of the trust; thus, it is logical that such beneficiaries would consider not exercising a Crummey power granted to them in the trust in order to preserve that interest. On the other hand, where a Crummey power beneficiary has only a discretionary income interest, or a contingent remainder interest (or no interest whatsoever in the income or principal of the trust), the Service views the non-exercise of the Crummey power as a prearranged understanding with the settlor that the Crummey power was not meant to be exercised or that the exercise would result in undesirable consequences.²¹

²⁰Neil, *supra* note 3, at 938.

²¹Spallino, *supra* note 30, at 91.

The material appearing in this website is for informational purposes only and is not legal advice. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. The information provided herein is intended only as general information which may or may not reflect the most current developments. Although these materials may be prepared by professionals, they should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

The opinions or viewpoints expressed herein do not necessarily reflect those of Lorman Education Services. All materials and content were prepared by persons and/or entities other than Lorman Education Services, and said other persons and/or entities are solely responsible for their content.

Any links to other websites are not intended to be referrals or endorsements of these sites. The links provided are maintained by the respective organizations, and they are solely responsible for the content of their own sites.