

Estate Planning Use of Crummey Powers

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Crummey powers can be included in any trust instrument governing a trust to which a settlor intends to make annual exclusion gifts. The trusts discussed in this section are irrevocable trusts designed to hold gifts and insurance policies. For the receipt of gifts, an irrevocable trust can be a separate taxpayer trust (a simple, straightforward trust to which irrevocable gifts are made) or an Intentionally Defective Grantor Trust under Internal Revenue Code §§ 671-677, the income of which is taxed to the grantor. The other type of trust that commonly uses Crummey powers is an Irrevocable Life Insurance Trust (usually a grantor trust) which holds an insurance policy on the life of the grantor, of which the grantor has no incidents of ownership (thus keeping the death benefit out of the grantor's gross estate for estate tax purposes).

For purposes of an Intentionally Defective Grantor Trust, if the grantor holds a power under Code §§ 673-677 and a beneficiary holds a Code § 678 power (such as a Crummey withdrawal power) over the same income, the beneficiary's power is disregarded, and the grantor is taxed as the owner of the trust income. The Code is, however, unclear concerning the grantor being taxed as the owner of the principal, because Code § 678(b) refers only to "income," whereas Code § 678(a)(1) refers to a beneficiary's power to vest "corpus or the income therefrom." It is possible that this is a drafting error, and that the grantor trumps the beneficiary as to both income and corpus. In several private letter rulings, the IRS has taken the position that the grantor is treated as the owner of the corpus (whenever possible) despite the existence of a Code § 678 power held by a beneficiary.¹

A Grantor's irrevocable contribution to a trust on a particular date, say December 31, is a completed gift as of that date (for gift tax purposes), even though the beneficiary does

¹ PLRs 9321050, 9309021, 9140127

not receive notice of the contribution until several days later and the beneficiary's Crummey withdrawal right does not expire until 30 days thereafter.² Interestingly, a Crummey withdrawal right granted to a spouse is a nondeductible terminable interest and does not qualify for the gift tax marital deduction (although the withdrawal right may qualify for the annual gift tax exclusion).³

Irrevocable Life Insurance Trusts (ILIT) have been a venerable tool in the toolbox of estate planners for years. ILITs are typically used to carry out one or more of the following estate planning purposes:

- (1) To remove the life insurance policy from the owner's gross estate;
- (2) To provide liquidity to pay estate taxes;
- (3) To serve as an asset replacement vehicle for assets that pass somewhere other than to the natural objects of the insured's bounty, such as to a charitable remainder trust; and
- (4) To serve as a guaranteed investment vehicle for some or all of the fixed income portion of an investment portfolio.⁴

The gift of a life insurance contract with the payment of premiums will not qualify as a present interest gift where payments to the beneficiaries are contingent upon such beneficiary surviving the insured or where the proceeds are not payable immediately at the insured-grantor's death, but rather are to be invested and paid during the beneficiary's lifetime. On the other hand, transfers of amounts to pay premiums to the trust can qualify for the annual exclusion to the extent the trust beneficiaries are given an immediate withdrawal right with

² Rev. Rul. 83-108

³ *Id.*

⁴ Spallino, *supra* note 30, at 91.

respect to the amounts transferred (i.e., the trust instrument holding the insurance policy contains Crummey powers).⁵

The trust in the *Crummey* case was not an Irrevocable Life Insurance Trust, however, the use of Crummey rights is very common in all irrevocable trusts. The Service has accepted the fact that Crummey demand notices are used and will not challenge a gift in trust, even if the beneficiary is a minor child without a guardian, so long as the trust and state law will not prevent the appointment of a guardian. The IRS has also stated it will no longer issue advance rulings to determine whether or not transfers of property in trust will be a gift of a present interest if the trust corpus is primarily life insurance on the life of the grantor and the trustee has the power to make premium payments from the trust income.⁶

⁵ James C. Magner, Linda R. Getzen and Edward F. Koren, *Irrevocable Trusts*, 2 EST. TAX & PERS. FIN. PLAN. § 19:58 (2011).

⁶ Frederick K. Hoops, Frederick H. Hoops, III, Daniel S. Hoops, *Life Insurance Trusts*, 1 FAMILY ESTATE PLANNING GUIDE §22:8, 4th Ed. (2010).

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