Hanging Crummey Powers

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A Hanging Crummey power allows the withdrawal right to lapse only for the amount that IRC § 2514(e) protects from treatment of release, which again is the gift amount less the greater of $5,000 or 5% of the value of the property out of which the withdrawal right could have been satisfied. A Hanging Crummey power provides that any withdrawal right remaining in excess of the 5 and 5 amount to be carried over to future years, lapsing only when it will not result in a taxable gift to the holder of the Crummey power.[1] This approach is a popular and creative technique designed to circumvent the 5 and 5 limitation and enable a grantor to obtain the full annual exclusion from gift tax without creating adverse tax consequences for a beneficiary.[2] Another benefit of using Hanging Crummey powers is to double the amount that a grantor may contribute to a trust under the gift tax annual exclusion amount. A grantor in conjunction with a spouse can use gift splitting under Code § 2513, coupled with hanging withdrawal power would permit under current law a $28,000 contribution free from tax under the annual gift tax exclusion.

A pesky consideration in using hanging Crummey Powers is the IRS has not favorably ruled on the use of Hanging Crummey powers; the single ruling on the issue seems to suggest that if the hanging power is not drafted as a condition subsequent, it should pass muster.[3]

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[1] Savinelli, *supra* note 27, at 77-79.
[2] Wilson, *supra* note 2, at 307.
[3] *See* PLR 88901004.

One consequence of using Hanging Crummey powers is that if a beneficiary dies while possessing a hanging power that has not fully lapsed, the value of the unlapsed hanging power will be included in the beneficiary's gross estate for estate tax purposes.[4] The beneficiary will also become the new transferor for GST purposes and the beneficiary's executor may need to allocate GST tax exemption to the included amount. There are no gift tax consequences to a beneficiary while he or she holds a Crummey withdrawal right that has not yet lapsed.[5] Additionally, a spouse should never be given a Hanging Crummey power in a generation skipping trust because the spouse's power may be deemed to create an estate tax inclusion period, which will prevent the grantor from allocating his or her GST exemption until the close of the period.[6]

Another consideration with a Crummey power, hanging or otherwise, is that such power is essentially an inter vivos general power of appointment. Anytime such a power of withdrawal exists, from an asset protection standpoint, a creditor might be able to demand the distribution in place of the beneficiary. A trustee in bankruptcy will have this power because the trustee has all rights of the debtor. State law on this issue may vary and in some states such power might be considered a personal right that cannot be exercised by a creditor. With a traditional Crummey trust, a creditor's ability to exercise the power will not have very much impact because the withdrawal right is triggered only on the making of a gift, shortly after which it expires;

[4] *See* I.R.C. § 2041(a)(2).
[5] Grassi, *supra* note 44, at 40-41.
[6] *Id*.

however, with the use of a hanging power, the potential for a beneficiary's having a continuing right to withdraw a very large sum of money from the trust could make the trust assets vulnerable to a creditor's claim.[7] Yet another consideration with the effect of a lapsed Crummey right on the spendthrift protections in the trust: Does an individual who has a right to vest trust property in himself or herself, which he or she does not exercise, after which the property irrevocably stays in trust, become the settlor of the trust as to the assets over which he or she held such power? If he or she is the settlor of the trust with respect to those assets, the spendthrift provision might be disregarded pursuant to the rule concerning self-settled trusts.[8]

<u>GST Contributions and Crummey Powers</u>

The use of trusts to transfer, preserve and protect wealth can implicate the Generation Skipping Transfer Tax ("GST") (IRC §§ 2601 et. seq.). A comprehensive discussion of the GST is beyond the scope of these materials but a brief treatment of the GST implications of a lapse of Crummey powers is included here. The GST consequences of a lapse of a Crummey power depend on whether the lapse is treated as a release. There are two deemed consequences for GST purposes when a lapse of a Crummey power is treated as a release: 1.) a deemed distribution/transfer by the trust to the holder of the Crummey power; and 2.) a deemed transfer back to the trust by the power

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[7] Osborne, *supra* note 38, at 2.
[8] *Id*.

holder. Generally, the deemed distribution to the Crummey power holder is treated as a taxable distribution to the power holder subjecting such person to paying the GST tax due. As to the second consequence, the issue is whether the deemed transfer by the Crummey power holder back to the trust is a completed gift subject to gift tax. Unless the trust is considered self-settled by the Crummey power holder (or if creditors of such power holder can force the exercise of a withdrawal power), then the deemed re-transfer is considered a completed gift subject to tax. [9]

[9] Peter B. Tiernan, *Considerations When Combining Crummey Powers with Total Discretionary Trusts*, THE FLORIDA BAR JOURNAL, Volume 83, No. 3 (March, 2009), 36.