

Trustee and Crummey Powers

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Crummey Powers and Estate Planning

I. Trustee and Crummey Powers

With Crummey trusts, the trustee has certain responsibilities with respect to giving beneficiaries notice of contributions subject to the withdrawal power and with handling any waivers of such withdrawal power by a beneficiary. There are certain defined parameters a grantor must observe to satisfy the IRS' requirements for a present interest gift. In Revenue Ruling 81-7, the IRS held that the Crummey powers cannot be illusory. This has come to mean two things: First, the beneficiary must be given notice that the power exists (and that a contribution subject to the power has been made to the trust);¹ Second, a valid power of withdrawal must endure for a reasonable period of time in order to provide the beneficiary with the opportunity to exercise.² The Crummey power does not effectively create a present interest unless the donee of that power, or the parent or guardian authorized by state law to exercise the power on the donee's behalf, is given reasonable notice of the power and a reasonable opportunity to exercise it before it lapses. Generally, it is well settled that a reasonable opportunity to exercise the power is approximately 30 days.³

The written notice should be retained by the trustee because substantiation of a claimed annual exclusion gift may be required on audit of

¹ However the Tax Court held in *Estate of Turner v. Commissioner*, T.C. Memo 2011-209; that notice was not required; the fact that the beneficiaries were not given notice did not affect their legal right to withdraw.

² Wilson, *supra* note 2, at 303-304.

³ Savinelli, *supra* note 27, at 73-74.

the donor's estate tax return many years after the gifts are made. Additionally, a new notice should be given each time property is transferred to trust.⁴ The trustee should also see that the transferred property is deposited in the trust and is available for withdrawal throughout the period prior to lapse.⁵ The withdrawal notice provision should be specific as to who is to receive notice and the contents of such notice should include instructions for exercise of the withdrawal power and information concerning time for such exercise and lapse.⁶ The timing and content of the letter is important, too. Deficiencies in these areas, specifically the trustee's failure to accurately describe the amount subject to withdrawal and sending the notice before the gift transfer was made, played a role in the IRS invalidating a gift tax annual exclusion.⁷

II. Problem Areas: Waivers and Informal Agreements

Beneficiaries of Crummey trusts may waive their power to withdraw prior to the time period for lapse has run. Because a Crummey withdrawal right is a general power of appointment, some commentators believe a beneficiary's waiver of the right of withdrawal constitutes a taxable release (and not a lapse) of a general power of appointment and constitutes a taxable gift of a future interest to the other trust beneficiaries. To avoid this potential adverse tax consequence, the beneficiary should not waive the

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ TAM 200341002

right to withdraw the trust contribution, rather the beneficiary should merely permit the right of withdrawal to lapse.⁸

The IRS has publicly announced that it will continue to litigate cases dealing with perceived abuses of Crummey powers. Similarly, the IRS has also indicated that it will continue to litigate cases whose facts indicate that the substance of the transfers was merely to obtain an annual exclusion and where no bona fide gift of a present interest was intended.⁹ One problem area is in the area of parental control over a minor child's Crummey powers. If a donee is a minor, notice and the authority to exercise the withdrawal right on behalf of the minor should be given to the donee's legal guardian or if the donee has no legal guardian the donee's parent. Additionally, if one of the parents is the grantor, it may be best for the instrument to designate the other parent of the minor as the person to receive notice. Even if the other parent is named, the IRS might argue that the notice is illusory. One solution might be to design an independent third-party in the trust instrument as an additional person to whom notice should be given on behalf of the minor.¹⁰ The problem with parental control in such a situation is that the minor beneficiary cannot be expected to make an effective demand, and thus the parent, as guardian, makes the minor child's decision to lapse for him. With parent/grantors, the problem in this scenario is that the parent

⁸ Grassi, *supra* note 44, at 41.

⁹ Savinelli, *supra* note 27, at 80.

¹⁰ John Gebauer, *Crummey Powers: Beneficiary Withdrawal Rights And Insurance Trusts – Requirements for Crummey Powers To Be Effective*, 28 CARMODY-WAIT 2d §165:258 (2011).

cannot be expected to make an impartial decision for the minor children because the parent retains a vested interest in the trust corpus.¹¹ The IRS will scrutinize these situations because such an arrangement effectively allows a donor to multiply the number of exclusions available to them without increasing the corresponding risk of exercise.¹²

The IRS has been particularly aggressive in litigating cases where they perceive informal agreements for waiver of Crummey withdrawal powers to be present. Even with proper notice and opportunity to exercise, donors may nonetheless control the situation through an agreement, either express or implied, that makes certain the beneficiary will not exercise his or her demand power. If the donor and the beneficiary have a prearranged agreement to allow the demand power to lapse, then the power is illusory, and in the IRS perspective the annual exclusion should be denied.¹³ The problem for the IRS with informal agreements is that their existence is very difficult to prove, in fact the Service has been unsuccessful in some well-known cases involving informal agreements, such as *Estate of Kohlsaat v. Commissioner* and *Estate of Holland v. Commissioner*, 73 T.C.M. 3236 (1997), (in which the Tax Court implicitly rejected the IRS' prearranged understanding test and permitted Crummey withdrawal rights to qualify for a gift tax annual exclusion when the beneficiaries had discussed in detail the

¹¹ *Id.* at 947.

¹² *Id.* at 949.

¹³ Neil, *supra* note 3, at 931-932.

purpose of the trust and their desire not to exercise the right of withdrawal).¹⁴

¹⁴ Grassi, *supra* note 44, at 38.



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