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CRUMMEY IS CRUMMEY

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[1] The comments contained in this paper are the individual views of the author who prepared them, and do not represent the position of the California Lawyers Association. Although the author might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, the author has not been specifically engaged by a client to participate on this project.

EXECUTIVE SUMMARY

All gifts of property are potentially subject to gift tax. A donor, receives an annual exclusion up to $16,000 on gifts made to any individual in 2022. There are other exceptions such as payment of tuition, if certain requirements are met. These payments are considered “qualified transfers” and are excluded, in addition to the annual gift tax exclusion, in determining the total amount of a donor’s gifts in any calendar year.

The annual exclusion is only allowed for gifts of a present interest. A present interest is “[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain).” If the gift is not a present interest, the annual exclusion under Internal Revenue Code (“IRC”) §2503 and the Treasury Regulations thereunder, will be denied.

Trusts are frequently used for estate planning purposes, but a gift into a trust, is generally not a present interest. A gift into a trust can qualify as a present interest and be eligible for the annual exclusion, under Crummey and its progeny.

Trusts are extremely important tools for estate planning purposes and trusts provide many forms of protection, beyond what the Service may be contemplating. They allow assets to be held until a beneficiary becomes more mature. Trusts can also provide creditor protection, including maintaining assets held in a trust as separate property, which will protect that property in the event of a divorce and can also avoid the income in the trust from being used in alimony calculations. For special needs beneficiaries, trusts are used so that public benefits will still be available, notwithstanding the assets in the trust, for a disabled beneficiary’s needs. In most situations, including in the foregoing situations, trusts are being used for non-tax reasons.

Requiring *Crummey* withdrawal provisions is an additional administrative step that should be removed because it is a seemingly unnecessary, administrative burdensome and can thwart a trustor’s intent. By removing the requirement of *Crummey* notices, a significant administrative burden on trustees would be lifted. Also, where beneficiaries are disabled, these notices cause a beneficiary to lose public benefits yet these beneficiaries are the only current income and remainder beneficiary under a special needs trust. Beneficiaries are often immature, have substance abuse issues or financial troubles and may exercise the withdrawal right, thwarting the trustor’s plan for the use of the trust assets. A gift to trust could still be classified as a present interest gift, as long as the current beneficiaries have certain

rights. This would also curb abuses by minimizing the number of annual exclusions. Thus, this author proposes that if a beneficiary has a current right to receive discretionary income distributions, that the present interest requirement to obtain the annual exclusion is met without the necessity of sending a *Crummey* notice.

DISCUSSION

I. BACKGROUND

A. Annual Exclusion and Present Gift Requirement

All inter-vivos transfers of property are potentially subject to gift tax. Under Internal Revenue Code ("IRC") Section 2503(c) a donor, however, can receive an annual exclusion of up to $16,000 in 2022 on any gift of property made to any person during a calendar year without using his or her lifetime exclusion amount. The annual exclusion however will only be allowed if the gift to an individual is a gift of a present interest in property. A present interest is defined as "[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain)." If the gift is not a present interest, the Service will deny the exclusion as under Internal Revenue Code ("IRC") § 2503 and the Treasury Regulations thereunder, it is clear that if the gift is composed of a future interest in property, then the annual exclusion will not be allowed.

There are also other exceptions under IRC § 2503(e). These are in addition to the current $16,000 annual exclusion and include paying someone's tuition, or medical expenses. If certain requirements are met these are not treated as gifts for purposes of the gift tax. To meet these requirements these gifts must be made directly to the medical provider or the educational institution in the case of tuition. These payments are considered "qualified transfers" and are excluded, in addition to the annual gift tax exclusion, in determining the total amount of a donor's gifts in any calendar year.

Treasury Regulation § 25.2503-6(b)(2) defines a qualifying educational organization as one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The unlimited exclusion is permitted for tuition expenses of fulltime or part-time students paid directly to the qualifying educational organization providing the education. No unlimited exclusion is permitted for amounts paid for books, supplies, dormitory fees, board, or other similar expenses which do not constitute direct tuition costs.

Treasury Regulation § 25.2503-6(b)(3) defines qualifying medical expenses as those limited to expenses defined in IRC § 213(d) and (e) (prior to January 1, 1984) and include expenses incurred for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body or for transportation primarily for and essential to medical care. In addition, the unlimited exclusion from the gift tax includes amounts paid for medical insurance on behalf of any individual. The unlimited exclusion from the gift tax does not apply to amounts paid for medical care that are reimbursed by the donee's insurance. Thus, if payment for a medical expense is reimbursed by the donee's insurance company, the donor's payment for that expense, to the extent of the reimbursed amount, is not eligible for the unlimited exclusion from the gift tax and the gift is treated as having been made on the date the reimbursement is received by the donee.

Although trusts are frequently used for estate planning purposes, they are used even more so today than when the regulations were adopted and this code section last reviewed. The Service does allow a very narrowly defined trust to be set up that is excluded from the present interest rules if certain conditions are met. An IRC § 2503(c) trust is a trust established for the benefit of a minor child and grants an exception to the general rule that only gifts of present interests qualify for the annual federal gift tax exclusion. The child must be under age twenty-one (21) in order to be the beneficiary of an IRC § 2503(c) trust. However, the child must have control of and receive distribution of the trust assets at age twenty-one (21). While children may have been responsible at the age of twenty-one in the 1980's, very rarely is a twenty-one-year-old responsible enough today to receive remaining funds from such a trust. Hence, these trusts are simply not used in the planning world today. The author would propose that if Crummey notices remain a requirement to make a gift into a trust a present interest that the IRC § 2503(c) trust termination age be expanded to at least age thirty (30).

Thus, today, the law remains that a gift into a trust, is generally not a present interest unless it meets the IRC Section 2503(c) trust requirements. While it is possible for an income interest to qualify as a present interest and be eligible for the annual exclusion, any remainder interest is considered a future interest to which the annual exclusion will not apply under the Treasury Regulations. This premise has now been eroded as provided herein. And, any gifts to a trust must follow certain requirements as provided below, which requirements are administratively cumbersome and in certain cases, like with special needs trusts would thwart the intent of the trustor of the special needs trust and taint the beneficiary from receiving public benefits, the very purpose of such a trust.

B. *Crummey vs. Commissioner of the Internal Revenue Service*, 397 F.2d 82, (9th Cir. 1968) ("*Crummey*")

The *Crummey* case, eroded the premise that a gift must be a present interest or in an IRC § 2503(c) trust. In the late 1960s, a taxpayer named D. Clifford Crummey came up with a solution, that by giving the trust beneficiary the right to draw out the money when it is given to the trust each year that was arguably a present interest. Here, in 1962, the taxpayers formed an irrevocable trust for the benefit of their four children. Contributions were made to the trust at various times in 1962 and 1963. Each taxpayer claimed a $3,000 per beneficiary annual gift tax exclusion, the relevant annual exclusion amount in the years in question. The 9th Circuit in overturning the portion of the Tax Court decision in the *Crummey* case that denied the annual exclusion for certain gifts, held that a gift in trust can be converted into a present interest by granting the beneficiaries a limited demand power or withdrawal right over a donor's contribution of property to the trust. This withdrawal right is referred to as a "*Crummey*" power, and the beneficiaries who receive the right are called powerholder(s). The court's reasoning in *Crummey* was that to the extent property contributed to a trust is subject to the withdrawal power, then, because the beneficiary may obtain immediate enjoyment of trust property by exercising the demand right, and thereby receiving the contribution or gift made to the trust, the beneficiary has a present interest in the property transferred to the trust.

C. Further Erosion By *Critsofani* and Other Case Law

Subsequent case law began to chip further away at *Crummey*. In *Estate of Cristofani v. Commissioner of the Internal Revenue Service*, 97 T.C. 74 (1991) the beneficiaries of a trust were children with the remainder passing to grandchildren (contingent beneficiaries). Maria Cristofani created an irrevocable inter-vivos trust to which she contributed property during each of the two years preceding her death. The value of each contribution was $ 70,000. The primary beneficiaries of the trust were her two children. Her five minor grandchildren had contingent remainder interests in the trust. In addition, the trust provided that Maria Cristofani's two children and five grandchildren each had the unrestricted right to withdraw an amount not to exceed the amount of annual gift tax exclusion under IRC Section. 2503(b) which at the time was $ 10,000, within 15 days following each of Maria Cristofani's contributions to the trust. If a child did not survive the survival period then grandchildren became the beneficiaries. Very significant to the court was that all of the beneficiaries, children and the contingent beneficiaries or grandchildren, were given an unrestricted right to demand immediate distribution of trust property following the transfer of property to the trust and they were all given *Crummey* notices.

With this notice the court held that the contingent beneficiaries were also treated as holding present interests in the trust, hence the gifts qualified for the annual gift tax exclusion. Since *Cristofani* allowed multiple annual exclusions, for current beneficiaries, the children and also for the contingent beneficiaries, the grandchildren, it actually worked in opposition to the government's desires because in these situations the amount of money flowing into the trust each year could be multiplied by any number of contingent beneficiaries.

Despite that, on two occasions, the Service has acquiesced to the result in *Cristofani*. In AOD 1996-010, the Service stated it will generally not contest annual exclusions for *Crummey* powers held by current income beneficiaries and persons with vested remainder interests.

Then again, in Estate of *Kohlsaat. v. Commissioner of Internal Revenue Service,* T.C. Memo. 1997-212 (1997), the court further expanded *Cristofani* when Judge Swift allowed annual exclusions for sixteen (16) contingent beneficiaries (donor's grandchildren) in addition to the donor's two children who were the current income beneficiaries. Here, Lieselotte Kohlsaat created an irrevocable trust and transferred a commercial building into the trust. The trust designated Beatrice Reinecke (Beatrice) and Peter Kohlsaat (Peter), the decedent's two adult children, as primary beneficiaries of the trust. Beatrice's three children and eight grandchildren were contingent remainder beneficiaries of Beatrice's one-half share of the trust, and Peter's spouse and four sons were designated as contingent remainder beneficiaries of Peter's one-half share of the trust. The trust gave each beneficiary the right to demand an immediate distribution from the trust property during a 30-day period of up to $10,000 which was the annual gift tax exclusion amount at the time of the gift. The demand right was sent within six days of the contribution to the trust and none of the beneficiaries exercised their demand right.

While *Cristofani* and *Kohlsaat* really involve a separate issue, using Crummey withdrawal rights to expand or multiply annual exclusions, the Service has acquiesced to allowing this treatment to allow this expansion of annual exclusion gifts. If that is the case, then the Service

should remove the *Crummey* requirement in cases where the beneficiary is the sole current income and principal beneficiary of his or her trust or sub-trust and as a result multiple Crummey notices could not be used to expand annual exclusion gifts to contingent beneficiaries who may never receive distributions from the trust.

Historically, the Service's position was also that no present interest exclusion would be available if a beneficiary does not receive actual notice of the *Crummey* withdrawal power. Plus, the Service required that there must be reasonable time within which the beneficiary has the right to exercise the power before its lapse. Originally, this *Crummey* notice was thought to require thirty (30) days, then fifteen (15) days, but today auditors have allowed the donor annual exclusion gifts in trust's even where there was no written notice. As such, many commentators suggest that oral notice is sufficient. Also, this notice has often become a "wink wink nod nod" as the beneficiary, and the beneficiary's representatives, all understand what is going on and the beneficiary is told not to exercise the power. As long as there is not proof of collusion, which has been raised by the Service, but has never been proven in any of the cases, courts have ignored any oral discussions between family members regarding not exercising the withdrawal power. This further erodes *Crummey* and to streamline gifts into trusts, the *Crummey* provisions should be removed.

II TRUSTS ARE EXTREMELY IMPORTANT TOOLS AND REMOVING CRUMMEY NOTICES WOULD ENHANCE THE USE OF THESE VEHICLES WHICH IS BENEFICIAL FROM A PUBLIC POLICY STANDPOINT

A. Trusts Have Many Benefits

Trusts are an extremely important tool for estate planning purposes and trusts provide many forms of protection, beyond what the Service may be contemplating. They allow money to be held in trust until a beneficiary becomes more mature. There are countless situations where a beneficiary is immature and may exercise the withdrawal right, thwarting the trustor's plan for the use of the trust assets, such as for a beneficiary's education. It is also not uncommon for a beneficiary with substance abuse issues or financial troubles, to withdraw the annual exclusion amount from the trust. No donor wants to give gifts outright to a beneficiary in these situations and even providing a Crummey letter provides a strong risk that an immature beneficiary will exercise the right of withdrawal. A properly drafted trust can also provide creditor protection, such as maintaining the assets in the trust as separate property, which will protect the trust property in the event of a divorce and will also avoid the income in the trust from being used in alimony calculations. For example, in a divorce, even income generated on separate property assets are used in many states for alimony calculations. Trusts can also assist in removing assets from a state's taxation system, minimizing a beneficiary's state income taxes. Since trusts are such important vehicles, they should be encouraged, and a trust's administration should be streamlined as much as possible. Removing the requirement of *Crummey* notices would assist in this regard.

B. Special Needs Trust

Trusts are regularly used for special needs beneficiaries so that public benefits will still be available, notwithstanding the assets in the trust, for a disabled beneficiary's needs. These can be set up by a relative of a child or an adult with special needs. They are often created when an individual has been disabled in an accident and is receiving recovery for personal injuries sustained in the accident. Specifically, special needs trusts ("SNT") are created and administered to allow the beneficiary of a trust to remain eligible for public benefits such as MediCal, MediCaid, SSI, SSDI, IHSS, public housing, and various other public resources, including providing state funding for care givers. Because these are needs-based programs, an outright gift to any individual who is on any needs based programs would jeopardize that beneficiary's eligibility for any of these programs. SNTs ensure eligibility is maintained without diminishing any government benefits while still providing discretionary powers to a trustee to utilize the trust's income and/or principal for the beneficiary's benefit. Basically, the income and principal in a SNT is used for an expenditure that the beneficiary will not receive from public benefits.

With a SNT, and in these cases, *Crummey* notices cannot be sent to the disabled beneficiary or that beneficiary will lose public benefits and government assistance. This is because if they have access to, or even a right to receive an annual gift of $16,000, whether they exercise that right or not, that beneficiary is deemed to not qualify for public assistance as in most states if a beneficiary has access to any amount in excess of $2,000 they will not qualify for public benefits and if they are receiving public benefits they will no longer be eligible to receive the public assistance often so badly needed. And, any SNT can only be set up for one beneficiary, so only one beneficiary is the current income and remainder beneficiary under the structure of these trusts. Once again, under the provisions of a SNT, the beneficiary does receive income and principal for needs, but these needs are only for those needs that public benefits does not already provide. Since a *Crummey* notice will violate the rules for SNT's under California and most state's laws because a beneficiary of a SNT is not allowed to have a right to withdraw money, a donor cannot utilize the annual exclusion for a beneficiary of a SNT when these beneficiaries are often those that are the most in need of and could use an annual exclusion gift.

C. Would Alleviate Administrative Burdens

Requiring *Crummey* withdrawal provisions is an additional administrative step that should be removed because it is seemingly unnecessary, administratively burdensome and can thwart a trustor's intent. This is particularly true because the requirements under *Crummey* have been significantly withered away. By removing the requirement of *Crummey* withdrawal notices or letters, a significant administrative burden on the trustee would be lifted. This would be a benefit because current rules mean that families have to hang on to these documents for a lifetime, lest the IRS challenge the exemption after the death of the person who established the trust. Also, *Crummey* withdrawal notices make lawyers and tax preparers a bit uneasy because now that the gift and estate tax limits are integrated, and if gift tax returns were not filed, the issue of reporting along with valuation of prior gifts, and hence gift tax, is not reckoned until the person dies and the estate tax return is filed. There are many cases where the IRS disputes valuation, notice and/or paperwork after death and in those cases it is difficult to locate records dating back many many years. In these situations, if only cash Crummey gifts are being made, a gift tax return is usually

not filed as it is not required, but to avoid searching for records dating back many years, filing a gift tax return would be prudent so the statute of limitations starts to run. These returns just clog up the system and provide the government with no real benefit. Thus, it makes sense to remove the requirement of Crummey notices as this would simplify a Trustee's record keeping.

D. Would Curb the Government's Perceived Abuses Such as in *Cristofani* and *Kohlsaat*

As described above if the requirement of Crummey notices were removed and rendered void, then there would be no method to use these notices to increase annual exclusion gifts to contingent remainder beneficiaries. This would then prevent multiple annual exclusion gifts for remote or contingent beneficiaries who will likely never receive distributions from the trust but who did receive the Crummey notice making any gift to the trust for them qualify for the annual exclusion gift. The Crummey notice was never intended to expand annual exclusion gifts to trusts under these circumstances, as it was intended to limit annual exclusion gifts. This would also provide a better tax policy.

III. SOLUTION

These situations could all be avoided, yet a gift to trust could still be classified as a present interest gift, so long as the current beneficiaries have certain rights. Thus, this author proposes that any gifts to a trust for the benefit of an individual would qualify for the annual exclusion and eliminate the requirement for formal *Crummey* power withdrawal notices only if:

1. a beneficiary has a current right to receive discretionary income distributions,
2. if no portion of the trust assets or income could be distributed to anyone else while the beneficiary is alive, and
3. the assets would be included in the beneficiary's estate if the beneficiary died before the trust is dissolved.

This would also follow the same policy established for the annual generation skipping transfer tax annual exclusion. When annual exclusion gifts are made to generation skipping trusts, as long as there is only one beneficiary of the trust and the assets in the trust are included in the skip persons estate, no generation skipping transfer tax exemption needs to be applied. Eliminating the *Crummey* requirement in these case makes sense and removes one more trap for the unwary, like those that believe qualifying for the annual generation skipping tax exclusion on contributions to a trust are sufficient without a *Crummey* notice.

As an alternative, if the above is not accepted, then on any annual exclusion gifts contributed to a SNT that as long as the above requirements in C 1-3 are met, and the SNT is a valid SNT under relevant state law, no Crummey notice will be required.

The author also proposes that as part of this *Crummey* relief, the Service could consider no longer allowing multiple annual exclusion gifts to a trust, where certain beneficiaries, such as for beneficiaries, who only have a temporary, remote or contingent interest, and have no present

beneficial rights if the primary beneficiary survives the survivorship period, as existed in the *Cristofani* case.

IV. CONCLUSION

In almost any situations where a trust is being used, one of the major reasons to use a trust is for non-tax reasons. These include immaturity of beneficiaries, creditor protection, minimizing state income taxation, and to preserve public benefits for beneficiaries of SNT's. Requiring *Crummey* notices is an administrative burden and can exasperate audit issues on the death of the Trustor if good records are not kept for all of the years in which annual exclusion gifts are made into a trust. Thus, the statute should be revised or the regulations should make clear that as long as the beneficiary of the trust that is receiving the annual exclusion gift is the current income beneficiary, sole principal beneficiary and the assets will be included in the beneficiary's estate, then no *Crummey* notice is required. Alternatively, there could be the one exception that if the trust is a SNT then no *Crummey* notice shall be required if there is only one beneficiary of the SNT, the assets are include in the beneficiary's estate on death and the SNT is a valid SNT under relevant state law.