Estate Tax Concepts

CRUMMEY POWER

Presented for

Valued Client

Presented by

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CRUMMEY POWER

The Concept…

- A “Crummy power,” named after the taxpayer who brought a court case, is used to secure the federal gift tax annual exclusion—$14,000 in 2017—for annual gifts to an irrevocable life insurance trust.
- These gifts are used to pay premiums on the life insurance policy held in the trust.

The Process…

- A Crummey power gives trust beneficiaries the power—exercisable each year for a limited time—to withdraw annual transfers to the trust.
- While the grantor hopes that the beneficiaries won’t exercise this power, the fact that they can is sufficient to qualify the annual transfers for the gift tax annual exclusion.
- Crummey powers generally lapse after the specified period expires if they’re not exercised, and the trustee is then free to use the recently transferred funds to pay premiums. For example, if four beneficiaries each have Crummey powers, up to $56,000 of annual transfers ($14,000 for each beneficiary) could be sheltered from the gift tax in 2017, or up to $112,000 when a husband and wife split the gifts.

Other Considerations…

- Regardless of the maximum gift tax annual exclusion, each beneficiary’s Crummey power is often limited to the greater of $5,000 or 5% of the trust principal. This amount won’t be considered a taxable gift to the other beneficiaries if the holder of the power allows it to lapse each year. However, amounts exceeding those limits are considered gifts to the other beneficiaries.
- Where lapses exceed the $5,000/5% limitations, Crummey power holders will have to draw upon their gift tax credit to shelter the gifts from tax. To avoid this result, irrevocable life insurance trusts sometimes limit Crummey withdrawal rights to the least of each beneficiary’s share of additions to the trust, the gift tax annual exclusion amount, or the greater of $5,000 or 5% of the trust assets.
- The trust language should give beneficiaries a reasonable time—such as 30 days—to exercise their powers. If the trust says they have until December 31 to exercise the power and the grantor makes a transfer on December 30, the IRS might view this as a sham. In that event, the opportunity to utilize the gift tax annual exclusion would be lost.

- The trustee should also give the beneficiaries formal notice that the trust received a transfer subject to their Crummey withdrawal powers, and indicate the period in which they may exercise their powers.

Bottom Line…

The Crummey power, which gives beneficiaries the limited right to withdraw assets from an irrevocable life insurance trust, is an effective technique to qualify gifts to the trust for the federal gift tax annual exclusion—whether the beneficiaries exercise that right or not.

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SUMMARY

What Are Crummey Powers?

“Crummey powers,” named after one taxpayer’s court case, are meant to secure the federal gift tax annual exclusion ($14,000 per donee in 2017) for annual gifts made to an irrevocable life insurance trust. These gifts are intended to provide the trustee funds to pay premiums on a life insurance policy held in the trust.

A Crummey power gives trust beneficiaries the power to withdraw the annual transfers during a limited period of time. The trustee notifies the beneficiaries when a transfer subject to their powers is made to the trust.

The grantor hopes that the trust beneficiaries won’t exercise their powers so that the funds will be available to pay premiums on the life insurance policy in the trust. But the mere fact that the beneficiaries are allowed to withdraw the money is sufficient to convert the annual transfers into gifts of a “present interest,” and thus qualify the transfers for the gift tax annual exclusion. Crummey powers usually lapse after the specified period expires if they’re not exercised, and the trustee is then free to use the transferred funds to pay premiums.

How Do They Work?

Notwithstanding the current $14,000 maximum gift tax exclusion, each beneficiary’s Crummey power is often limited to the greater of $5,000 or 5% of the trust principal. This is the annual amount that won’t be considered a taxable gift to the other trust beneficiaries if the holder of the power allows it to lapse.

The lapse of a Crummey power is, however, considered a gift to other trust beneficiaries to the extent that it exceeds the $5,000 or 5% limit. In that event, the beneficiaries may have to draw on their gift tax credit to shelter the resulting taxable gifts from the gift tax.

To avoid this unfortunate result, Crummey trusts are sometimes drafted to limit the withdrawal right to the least of the beneficiary’s proportionate share of additions to the trust, the gift tax annual exclusion amount, or the greater of $5,000 or 5% of the trust assets.

Also, the trust should give the beneficiaries a reasonable period of time—say, 30 days—to exercise their powers. A shorter period might cause the IRS to question the motive behind an attempted transfer. For example, if the trust says beneficiaries have until December 31 to exercise their powers, and the grantor makes the transfer on December 30, the IRS might view this as a sham, and the gift tax annual exclusion would be lost.

It’s also important that the trustee formally notifies beneficiaries when the trust has received a transfer subject to their Crummey withdrawal powers, and indicates the period during which they may exercise these powers.

The Crummey power can be an effective way to avoid needless federal gift taxation of transfers needed to support a life insurance policy held in trust.


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