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The Crummey Power

An Unfortunate Name for a Valuable and Important Right

By Abbe I. Herbst

For many clients, a major component of their estate plans is an irrevocable life insurance trust. In such trusts, the owners and beneficiaries of one or more life insurance policies on the client's life are the trustees of the client's insurance trust. If properly administered, the death benefits will not be included in the insured's estate, and can be used as a source of liquidity to pay the estate taxes on other assets, to provide the funds to purchase a deceased owner's share of a business pursuant to a buy-sell or shareholders' agreement, or simply to provide for the care and support of loved ones. If, on the other hand, the insured client is the owner of the policies, the proceeds will be included in the client's estate for estate tax purposes, and may be subject to estate taxes upon death.

Typically, the insured pays the premium due on the policy owned by the trust by issuing a check to the trustees for slightly more than the premium, which the trustees deposit to an account in the name of the trust. Later, the trustees write a check to the insurance company for the amount of the premium. The contribution by the insured to the trustees should be made at least 60 days before the premium is actually due to be paid.

The addition of funds by the insured to the life insurance trust is considered a gift. In order for a gift to qualify for the $12,000 gift tax annual exclusion (or $24,000 if the spouse of the insured consents to "split" all gifts with the insured), the Internal Revenue Code requires that the gift must be a gift of a present interest. A transfer to a trust that allows its beneficiaries the unrestricted right to the immediate use, possession or enjoyment of the transferred property, or the income from the property, is a gift of a present interest that qualifies for the annual gift tax exclusion. In most life insurance trusts, the terms of the trust provide that all distributions are within the discretion of the trustees during the insured's lifetime. How then, can the additions to the trusts qualify for the annual gift tax exclusion, so that the insured does not use any part of his or her lifetime gift exemption of $1 million through the payment of premiums?

Enter Crummey v. Commissioner

The 1968 case of *Crummey v. Commissioner*, 397 F.2d 82, established the rule that if the beneficiaries of a trust are given the right to withdraw amounts added to the trust for a specified period of time after the addition, such an unrestricted right to the immediate use, possession or enjoyment of the trust addition, whether or not exercised by the beneficiaries, makes the addition one of a present interest which qualifies for the annual gift exclusion. This right of withdrawal has come to be known as the "Crummey power" and the notice of the power is commonly called the "Crummey notice." They are included in virtually all irrevocable life insurance trust agreements.

Although this article has been discussing Crummey powers in the context of life insurance trust agreements, their usefulness is not limited to life insurance trusts. Crummey powers can

also be included in other types of trust agreements, such as those in which distributions of income or principal to the beneficiary are within the discretion of the trustees, but additions are made to the trusts and the donor wishes to have such additions constitute gifts of present interests, so that they can qualify for the gift tax annual exclusion.

It is crucial that the beneficiaries receive the Crummey notices from the trustees of the insurance trust promptly after the contribution to the trust has been made and that they be afforded a reasonable opportunity to exercise their Crummey powers before the powers lapse. Periods of just a few days have been held to be illusory, with the result that the addition to the trust will not qualify for the gift tax annual exclusion. My preference is for a period of at least 60 days for the beneficiaries to exercise their Crummey powers, but in no event less than 30 days. The beneficiaries, being aware that they will share in what will be significant amounts of life insurance upon the death of the insured, rarely exercise their Crummey powers, opting instead to have the contributions used to pay the premiums.

The requirement of a Crummey notice is not just meaningless legal boilerplate. It is a very real requirement that must be obeyed, or else the insured faces the risk that the additions to the trust for premium payments will be considered gifts of future interests, requiring the filing of gift tax returns, eroding the insured's $1 million lifetime gift exemption, and possibly resulting in increased estate taxes.

Helpful Tip

In the course of a gift tax audit or an audit of a federal estate tax return, the IRS will often ask for copies of the Crummey notices if the donor or decedent had been the creator of an irrevocable life insurance trust. When the periodic Crummey notices are sent, the trustees should either include copies for the beneficiaries to date, sign and return, acknowledging receipt of the notices, or send the notices by certified mail, return receipt requested, as proof that the notices were sent. The acknowledgments or proofs of mailing should be retained by the trustees indefinitely as part of the trust records.

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