Crummey Trusts for Minors

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The Internal Revenue Code of 1954 (Code) imposes a tax on all transfers of property by gift.[1] To avoid the administrative nightmare of keeping track of every small gift,[2] the Code allows an annual exclusion of a certain amount of gifts made to each donee.[3] The annual exclusion for gifts made after December 31, 1981, was increased from $3,000 to $10,000.[4] The increased exclusion allows a parent[5] to make gifts worth up to $10,000 per year to each child (and to any other person the parent wishes to benefit) without incurring gift tax liability on the transfer.[6] These gifts can be a

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1. I.R.C. § 2501(a)(1) (West Supp. 1982). Specifically, the tax is imposed "for each calendar year on the transfer of property by gift during such calendar year by any individual." *Id.* The donor of the gift is primarily liable for payment of this tax. Treas. Reg. § 25.2511-2(a) (1958). For the transfer to be taxable, the gift must be "complete." *See id.* § 25.2511-2(b). A "complete" gift is one in which the donor has made an "irrevocable and gratuitous transfer of property," Rev. Rul. 57-315, 1957-2 C.B. 624, and has "so parted with dominion and control as to leave in him no power to change its disposition." Treas. Reg. § 25.2511-2(b) (1958). A transfer in trust for the benefit of a third party may constitute a complete gift and be subject to gift tax. I.R.C. § 2511(a) (1976) states: "[T]he tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise."

2. H.R. REP. No. 708, 72d Cong., 1st Sess. 29 (1932), *reprinted in The Revenue Bill of 1932*, 99 U.S. REVENUE ACTS 1909-1950 § 504 (B. Reams ed. 1979). The annual exclusion is also considered an incentive to make gifts. *See* H.R. REP. No. 1380, 94th Cong., 2d Sess. 12, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3356, 3366.

3. I.R.C. § 2503(b) (West Supp. 1982). This section of the Internal Revenue Code (Code) provides in pertinent part as follows:

> In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year.

Id.

To obtain the annual exclusion, the gift must be one of a present interest in property. *Id.* The Treasury Department has defined a "present interest in property" as "[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from property." Treas. Reg. § 25.2503-3(b) (1958). The gift does not have to be made to an individual to qualify for the exclusion. Although the Code language refers to gifts made to any "person," this term includes "an individual, a trust, estate, partnership, association, company or corporation." I.R.C. § 7701(a)(1) (1976).

4. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 442(a)(3)(B), 95 Stat. 172, 320-21 (codified at I.R.C. § 2503(b) (West Supp. 1982)).

5. A husband and wife can jointly make a gift of up to $20,000 to a third party and still qualify for the annual exclusion. I.R.C. § 2513(a) (West Supp. 1982). This section allows all gifts made by either spouse during the year to be treated as made one-half by each spouse, as long as the other spouse consents to this treatment. *Id.* The procedure is known as "gift-splitting."

6. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 442(a)(3)(B), 95 Stat. 172, 320-

useful planning tool for parents who wish to set aside a fund for their minor children's future enjoyment, without having to pay gift taxes on the transfers. Although several alternatives exist for utilizing the annual gift tax exclusion, one method gaining popularity is the "Crummey" trust.[7] This trust provides an opportunity to take advantage of the annual gift tax exclusion, and can be drafted to shift income and estate tax liabilities away from the grantor.

This Note will briefly discuss some alternatives available to parents who wish to take advantage of the increased annual gift tax exclusion by making gifts to their children. In particular, this Note will discuss the gift, income and estate tax ramifications of the "Crummey" trust and the utility of establishing such trusts for minors. Potential problem areas will be pointed out, and some possible solutions will be suggested.

Gifts to Minors

Three general methods are available to make gifts to minors that will qualify for the annual gift tax exclusion.[8] First, a parent (or other person) can make an outright gift to a child.[9] The problem with this method, of course, is that a child generally is not considered sufficiently mature to manage the gift property satisfactorily.[10] A conservator may be appointed for the child,[11] but this requires a court proceeding,[12] the posting of a bond,[13] and regular accountings to the court.[14] Also, a bank account may be opened in the name of the minor, but if the minor is able to sign his name and understand the nature of his act, he will be able to withdraw the funds.[15] Consequently, outright gifts are not a suitable option for parents

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321 (codified at I.R.C. § 2503(b) (West Supp. 1982)). No gift tax return is required for gifts made in any year that total $10,000 or less per donee because the gifts are not included in taxable gifts. *See* I.R.C. §§ 2503(a)-(b), 6019(1) (West Supp. 1982). But see Treas. Reg. § 25.2513-2(a), T.D. 7238, 1973-1 C.B. 544, 566, that requires a gift tax return to be filed if a husband and wife intend to split the gift. *See supra* note 5.

7. The name is derived from the case of Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968). The "Crummey" label is generally used to refer to a provision in a trust giving a beneficiary the right to demand part or all of the income or corpus of the trust. In this Note, the term "Crummey" trust will be used to refer to a trust containing such a provision.

8. Childs, *Lifetime Gifts to Minors*, 51 OKLA. B.J. 2533, 3534-35 (1980); Waugh & O'Sullivan, *Gifts to Minors—Crummey and Short Term 2503(c) Trusts*, 49 KAN. B.A.J. 257, 258-59 (1980); Whiteside, *Giving gifts to minors can still result in significant income and estate tax savings*, 8 TAX'N FOR LAW. 282, 283-84 (1980).

9. Rev. Rul. 54-400, 1954-2 C.B. 319; *see* S. SURREY, W. WARREN, P. MCDANIEL & H. GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 670 (2d ed. 1982) [hereinafter cited as S. SURREY].

10. *See supra* note 8.

11. In Arizona, a "conservator" is appointed by the court to manage the estate and property of a minor. ARIZ. REV. STAT. ANN. §§ 14-1201(6), -5401(1) (1975).

12. *Id.* §§ 14-5402, -5404, -5405, -5407, -5408 set forth the procedures for appointing a conservator.

13. *Id.* § 14-5411 sets forth the bond requirements for a conservator.

14. *Id.* §§ 14-5418, -5419 describe the accounting procedure.

15. See *id.* §§ 6-235(A), -432 (1974 & Supp. 1974-82) which allow banks and savings and loans to pay account funds to a minor who is named on the account. Savings bonds can also be purchased in the child's name, but again, the child would be able to redeem the bonds simply by being old enough to endorse the bonds and understand the transaction. 31 C.F.R. §§ 315.39, .40, .63 (1981).

who are reluctant to place substantial property in the control of a minor.[16]

The second way for a parent to take advantage of the annual gift tax exclusion is to make gifts to a custodian for the minor under the Uniform Gifts to Minors Act.[17] The major drawback to a custodianship is that the custodian is required by statute to relinquish the fund to the child at the age of eighteen.[18] Many parents believe their child will be too immature or lack sufficient knowledge at eighteen to manage a large fund properly.[19] Another problem is that in Arizona such gifts are limited to insurance policies, annuity contracts, securities and money.[20] Additionally, if the child dies prior to distribution of the fund, the property will likely return to the parents as heirs of the deceased child.[21] Finally, if the parent/donor serves as custodian and dies during the custodianship term, the fund will be subject to estate taxation in the parent's gross estate.[22] A custodianship is not suitable, therefore, for parents who want to achieve the following objectives: (1) reduce the estate tax due at their deaths by transferring property to their children; (2) transfer to their children property other than insurance policies, annuity contracts, securities or money (for example, real property); and (3) obtain suitable management of the property until the children are able to manage the fund.

The third option is a transfer in trust.[23] A parent can set up a trust by opening a bank account in his own name, as trustee for the minor.[24] Unless expressly made irrevocable, the trust property is considered to be owned by the trustee.[25] As such, the trust income may be taxed to the parent/trustee[26] and the trust property may be includible in the parent's gross estate.[27]

Irrevocable living trusts[28] are more useful planning tools for parents.

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16. DRAFTING CALIFORNIA IRREVOCABLE INTER VIVOS TRUSTS § 7.43, at 32 (J. Cohan & I. Slater eds. 1973) [hereinafter cited as DRAFTING CALIFORNIA TRUSTS].

17. ARIZ. REV. STAT. ANN. §§ 44-2071 to -2080 (1967 & Supp. 1982-83) set forth the Arizona version of the Uniform Gifts to Minors Act. The Internal Revenue Service (Service) has ruled that a gift to a minor under the Uniform Gifts to Minors Act qualifies for the annual gift tax exclusion. Rev. Rul. 59-357, 1959-2 C.B. 212.

18. ARIZ. REV. STAT. ANN. § 44-2074(D) (Supp. 1982-83).

19. Whiteside, *supra* note 8, at 284.

20. ARIZ. REV. STAT. ANN. §§ 44-2071(5)(a), -2072(A) (Supp. 1982-83).

21. *Id.* § 14-2103(A)(2) provides that the intestate estate will pass to the parents of the decedent if there is no surviving spouse or issue. In Arizona, a person must be at least 18 years old to execute a will. *Id.* § 14-2501 (1975). Consequently, the property of an unmarried and childless minor decedent passes to the parents if one or both survive the minor. *Id.* § 14-2103(A)(2) (Supp. 1982-83).

22. Rev. Rul. 70-348, 1970-2 C.B. 193; Rev. Rul. 59-357, 1959-2 C.B. 212; Rev. Rul. 57-366, 1957-2 C.B. 618.

23. Childs, *supra* note 8, at 2535; Waugh, *supra* note 8, at 259; Whiteside, *supra* note 8, at 284.

24. This arrangement is termed a "Totten Trust," derived from *In re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904).

25. *See* ARIZ. REV. STAT. ANN. §§ 14-6101(14), -6103(c) (1975).

26. *See* I.R.C. §§ 671, 674, 677 (1976 & West Supp. 1982).

27. *See id.* §§ 2036(a), 2038(a)(1) (1976 & Supp. IV 1980).

28. An irrevocable trust may provide greater tax savings to a parent/grantor than would a revocable trust. The grantor of a revocable trust is treated as its owner and taxed on the trust income. *See id.* §§ 671, 676 (1976). Additionally, the assets of a revocable trust are included in the gross estate of the grantor for estate tax purposes. *Id.* § 2038(a)(1). Thus, to achieve maximum income and estate tax savings, the parent/grantor must "part with all dominion or control

Their use can reduce the grantor's income taxes by distributing income among family members in lower tax brackets.[29] The use of such trusts also can reduce the grantor's gross estate for estate tax purposes,[30] and can reduce the grantor's gift taxes by providing a means to use the annual gift tax exclusion.[31] Trusts are also more flexible than an outright gift or a custodianship. Any type of property can be transferred to a trust;[32] examples are cash, stocks, bonds, real estate, and life insurance policies. Additionally, the trust can be tailored to fit the specific needs of the grantor; for example, the trustee can be given either broad discretion or narrowly defined duties in the accumulation and distribution of the trust funds.[33]

Three popular trusts for the benefit of minors are the "short-term trust," the "2503(c) trust," and the "Crummey" trust. The short-term trust[34] is an irrevocable trust set up for a period of at least ten years, with the corpus reverting to the grantor at the termination of the trust.[35] During that ten-year period, the income from the trust corpus may be distributed to the beneficiaries or it may be used or accumulated for the beneficiaries' benefit.[36] The advantage of a short-term trust is that the income is taxed to the trust or the beneficiaries rather than to the grantor.[37] A disadvantage is that the value of the grantor's reversionary interest is includible in the grantor's gross estate if he dies before the trust terminates.[38] Additionally, since the ten-year period must begin anew at each additional contribution to the trust,[39] this trust is not suitable for the grantor who plans to make frequent contributions to a trust but wants the trust property returned to him within a few years.[40]

The 2503(c) trust is advantageous for parents who wish to reduce their income and estate taxes while minimizing their gift tax liability. Section 2503(c) of the Code provides that certain gifts in trust for the benefit of

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over the trust and its assets to avoid being taxed as the owner of the trust or its income." G. BOGERT & G. BOGERT, TRUSTS & TRUSTEES § 264.10, at 396 (2d rev. ed. 1977) [hereinafter cited as G. BOGERT].

A "living trust" is one that is established and operates during the lifetime of the grantor. BLACK'S LAW DICTIONARY 843 (5th ed. 1979).

29. J. RITCHIE, N. ALFORD, JR. & R. EFFLAND, DECEDENTS' ESTATES & TRUSTS 389-90 (5th ed. 1977); *see* DRAFTING CALIFORNIA TRUSTS, *supra* note 16, § 7.1, at 4.

30. *See* I.R.C. § 2038 (1976); G. BOGERT, *supra* note 28, § 264.10, at 393; Whiteside, *supra* note 8, at 284.

31. *Cf.* I.R.C. § 2503(a)-(b) (West Supp. 1982).

32. Whiteside, *supra* note 8, at 284.

33. *Id.*; G. BOGERT, *supra* note 28, § 264.10, at 396. For example, a trustee could be given complete discretion in distributing trust income, or may be limited to distributing income only for educational purposes of the beneficiary.

34. This type of trust is also known as a "Clifford trust," "Section 673 trust," or "reversionary trust." Reish, *Self-Trusteed Clifford Trusts: Planning for the Taxpayer with College Bound Children or Elderly Parents*, 51 L.A.B.J. 412, 412 (1976); Whiteside, *supra* note 8, at 286.

35. Reish, *supra* note 34, at 412-13; Whiteside, *supra* note 8, at 286.

36. G. BOGERT, *supra* note 28, at 404.

37. I.R.C. § 673 (1976) provides that the grantor will be treated as the owner of a trust in which he has a reversionary interest if the interest will take effect within ten years. This ownership results in the grantor being taxable on the trust income. If the corpus will not revert to the grantor within ten years, the trust income is taxed to either the trust or the beneficiaries. Reish, *supra* note 34, at 412; Whiteside, *supra* note 8, at 286.

38. I.R.C. § 2033 (1976); Reish, *supra* note 34, at 414; Whiteside, *supra* note 8, at 286.

39. I.R.C. § 673 (1976); Whiteside, *supra* note 8, at 286.

40. Whiteside, *supra* note 8, at 286.

persons under the age of twenty-one will be deemed gifts of present interests in property.[41] As such, the gift is eligible for the annual gift tax exclusion of section 2503(b).[42] The disadvantage of the 2503(c) trust is that it must be terminated and the corpus and accumulated income distributed to the beneficiary at age twenty-one.[43]

The "Crummey" trust[44] combines the benefits of the annual gift tax exclusion and the income and estate tax advantages an irrevocable trust can provide with the ability to delay distribution of the trust funds to a date acceptable to the grantor.[45] Because of the interrelation of the income, estate and gift tax laws, however, the "Crummey" trust must be carefully drafted. In the next four sections of this Note, the gift, income and estate tax ramifications of the "Crummey" trust for minors, as well as some problems associated with its use, will be examined.

Crummey Trusts and the Annual Gift Tax Exclusion

A gift must be a transfer of a present interest in property to qualify for the annual gift tax exclusion.[46] A gift in trust, however, often does not convey a present interest in the property to the trust beneficiary.[47] One way of satisfying the present interest requirement is to give the trust beneficiary the right to demand distribution of the corpus.[48] This demand right

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41. I.R.C. § 2503(c) (1976) states:

> No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom—
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> (1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and
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> (2) will to the extent not so expended—
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> (A) pass to the donee on his attaining the age of 21 years, and
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> (B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

42. *Id.* § 2503(b); Waugh, *supra* note 8, at 259; Whiteside, *supra* note 8, at 285.

43. I.R.C. § 2503(c)(2)(A) (1976); Childs, *supra* note 8, at 2535; Whiteside, *supra* note 8, at 285. The Treasury regulations allow the donee to extend the term of the trust when he or she attains age 21. Treas. Reg. § 25.2503-4(b)(2) (1958). Although the Service had ruled that a gift to a 2503(c) trust would not qualify for the annual exclusion if the beneficiary was required to perform a positive act at age 21 to terminate the trust, Rev. Rul. 60-218, 1960-1 C.B. 378, the Service subsequently reversed its position in Rev. Rul. 74-43, 1974-1 C.B. 285. Because of recent case law against its previous position, the Service stated that a gift to a minor in trust will satisfy § 2503(c) requirements if the beneficiary has, at age 21, either

> (1) a continuing right to compel immediate distribution of the trust corpus by giving written notice to the trustee, or to permit the trust to continue by its own terms, or (2) a right during a limited period to compel immediate distribution of the trust corpus by given [sic] written notice to the trustee which if not exercised will permit the trust to continue by its own terms . . . .

Id. at 286. *See also* Heidrich v. Commissioner, 55 T.C. 746 (1971); Griffith v. United States, 63-1 U.S.Tax Cas. (CCH) ¶ 12,124, at 88,397 (S.D. Tex. 1962).

44. *See supra* note 7.

45. DRAFTING CALIFORNIA TRUSTS, *supra* note 16, § 10.32, at 160; *Demand period of 30 days okayed for Crummey trust*, 53 J. TAX'N 34, 35 (July 1980); *see infra* notes 46-72 and accompanying text.

46. *See supra* note 3 and accompanying text; *see also* I.R.C. § 2503(b) (West Supp. 1982); Treas. Reg. § 25.2503.3 (1958 & T.D. 7238, 1973-1 C.B. 544, 563-64).

47. Christensen, *Defective Income Tax Powers,* Crummey *Clauses and the IRS*, 119 TR. & ESTS. 68, 69 (June 1980).

48. Christensen, *supra* note 47; *see* Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

constitutes a present interest in the property because the beneficiary can obtain immediate enjoyment of the property by making the demand.[49] How limited the grantor can make a demand right and still convey a present interest was the subject of *Crummey v. Commissioner*.[50]

In *Crummey*, the donor created a trust for the benefit of his four children.[51] The trust agreement permitted each beneficiary to demand, at any time during the year in which an addition was made to his or her share of the trust, the lesser of the full amount of the addition or $4,000.[52] The right lapsed, however, on December 31 of the year in which the addition was made.[53] The trust also provided that if the child was a minor at the time of the gift, the child's guardian could make the demand on the child's behalf.[54] The trustee was to accumulate the income of each beneficiary's share until such beneficiary reached the age of twenty-one; thereafter, all income was to be distributed annually to the beneficiary.[55] When the beneficiary reached age thirty-five, the trustee, in his discretion, was to distribute both the income and corpus to the beneficiary.[56] The case arose because the Internal Revenue Service (Service) disallowed the annual gift tax exclusion for additions to the trust.[57]

The case turned on whether present interests were created by giving the beneficiaries demand rights in the additions to the trust.[58] The Ninth Circuit concluded that the determinative factor was whether the beneficiaries had the "right to enjoy" the gifted property, and not whether they actually received the property.[59] The court found that the minors had a present right to enjoy the trust additions because each minor, or the parent as natural guardian, could make a demand on the trustee for the minor's share of the additions, and this demand could not be legally resisted by the

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It is assumed, however, that the parent will discourage a minor beneficiary from exercising the demand right. *See* Leimberg, *Section 2503(b)—Use of Trusts and the Gift Tax Exclusion*, 38TH ANN. N.Y.U. INST. § 42.05, at 42-33 (1980); Natbony, *The* Crummey *Trust And "Five and Five" Powers After ERTA*, 60 TAXES 497, 498-99 (1982).

49. Christensen, *supra* note 47, at 69; see *supra* note 3 for the definition of a present interest.

50. 397 F.2d 82 (9th Cir. 1968).

51. *Id.* at 82.

52. *Id.* at 83.

53. *Id.*

54. *Id.*

55. *Id.* at 86.

56. *Id.*

57. *Id.* at 83.

58. *Id.* at 83-84. The *Crummey* trust differed from trusts in previous cases in that its demand right was limited to the amount of each addition. *Id.* at 83. Demand rights in other trusts gave the donee rights in all of the trust property. *See* Gilmore v. Commissioner, 213 F.2d 520 (6th Cir. 1954); Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952); Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951).

59. 397 F.2d at 88 (relying on Gilmore v. Commissioner, 213 F.2d 520 (6th Cir. 1954), and George W. Perkins, 27 T.C. 601 (1956)). In reaching this conclusion, the *Crummey* court declined to follow the ruling set forth in Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952). 397 F.2d at 88. The *Stifel* court had examined the surrounding circumstances as well as the trust agreement and held that since a guardian had not been appointed to make the demand on behalf of the child, it was unlikely the demand power would be exercised; therefore, the gifts were held to be gifts of future interests. 197 F.2d at 110-11. The court in *Crummey* believed the *Stifel* ruling would result in an "inconsistent and unfair" solution in that exclusion would be allowed for adult beneficiaries, but not for minor beneficiaries. 397 F.2d at 88.

trustee.[60] Consequently, the donors were allowed the annual gift tax exclusion.[61] The exclusion was allowed even though the court recognized that the circumstances made it highly unlikely that a demand would ever be made.[62] First, although the parents as natural guardians could make the demand, a legal guardian would have to be appointed to receive the property, and no guardian had been appointed.[63] Second, the court noted it was probable that the beneficiaries were not aware of the demand right and did not know when contributions were made to the trust.[64] Third, the transfers were made toward the end of the year so the time in which to make a demand was severely limited.[65]

The *Crummey* holding was contradictory to the Service's position that if no guardian had been appointed for a minor beneficiary the gift transfer was a future interest and not eligible for the section 2503 exclusion.[66] Five years after the *Crummey* decision, the Service changed its position and ruled that a section 2503(b) annual exclusion would be allowed so long as no hindrance existed under local law or the trust agreement that would bar the appointment of a guardian for the minor donee.[67] Although the Service appears to accept the *Crummey* decision, some modifications of the "Crummey" demand right may be required to avoid a dispute with the Commissioner.

Perhaps the most important modification is to allow the beneficiary sufficient time in which to exercise the demand right, making appointment of a guardian possible.[68] Local law should be consulted to determine how much time is required for the appointment of a guardian.[69] In addition,

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60. 397 F.2d at 87-88 (relying on George W. Perkins, 27 T.C. 601 (1956)).
61. *Id.* at 88.
62. *Id.*
63. *Id.* at 84, 88.
64. *Id.* at 88.
65. *Id.*
66. Rev. Rul. 54-91, 1954-1 C.B. 207, *revoked*, Rev. Rul. 73-405, 1973-2 C.B. 321.
67. Rev. Rul. 73-405, 1973-2 C.B. 321. The demand right in this revenue ruling, however, was substantially different from a "Crummey" power in that it did not lapse at the end of the calendar year. *See id.* Thus, the position of the Service as to "Crummey" provisions remained unclear. *See* Christensen, *supra* note 47, at 68; *Limited corpus demand right creates present interest*, 49 J. TAX'N 164, 165 (Sept. 1978). More recently, Revenue Ruling 81-6 and several private letter rulings have upheld the validity of a noncumulative annual demand right similar to that in *Crummey*. *See* Rev. Rul. 81-6, 1981-1 C.B. 385; 282 IRS LETTER RUL. RPTR. (CCH) 8229097 (Apr. 22, 1982); 235 IRS LETTER RUL. RPTR. (CCH) 8134135 (MAY 28, 1981); 222 IRS LETTER RUL. RPTR. (CCH) 8121051 (FEB. 26, 1981); 212 IRS LETTER RUL. RPTR. (CCH) 8111122 (Dec. 19, 1980); 204 IRS LETTER RUL. RPTR. (CCH) 8103074 (Oct. 23, 1980); 204 IRS LETTER RUL. RPTR. (CCH) 8103069 (Oct. 23, 1980); 171 IRS LETTER RUL. RPTR. (CCH) 8022048 (Mar. 4, 1980); 135 IRS LETTER RUL. RPTR. (CCH) 7939061 (June 27, 1979).

Although private letter rulings may not be relied on as precedent, I.R.C. § 6110(j)(3) (1976), they are useful indications of the Service's position on particular types of transactions. *See* Rowan Cos., Inc. v. United States, 81-1 U.S. Tax. Cas. (CCH) ¶ 9479, at 87,412 n.17 (U.S. 1981); Lischer, *The "Crummey" Trust*, 4 EST., GIFTS & TR. J. 17, 18 n.12 (July-Aug. 1979).

68. *See* 118 IRS LETTER RUL. RPTR. (CCH) 7922107 (Mar. 5, 1979) (under state law at least three days' time is necessary for appointment of a guardian, so an addition made within three days of the lapse of the demand right would not qualify for the annual gift tax exclusion); 152 IRS LETTER RUL. RPTR. (CCH) 8003033 (Oct. 23, 1979) (a 30-day demand period was upheld); 171 IRS LETTER RUL. RPTR. (CCH) 8022048 (Mar. 4, 1980) (no opinion was expressed whether additions made during December would qualify for the annual exclusion since several days' time was required for appointment of a guardian and the demand right lapsed on December 31).

69. In Arizona, additions made approximately 30 days before the lapse of the demand right

the trust should provide that the beneficiaries must be notified of their demand rights when the trust is executed and when contributions are made to it.[70] Another helpful provision would require the trustee to hold sufficient liquid assets in the trust to satisfy all demand rights.[71] Although these provisions may not be necessary under *Crummey*, their use will insure each addition's uncontested eligibility for the annual gift tax exclusion.[72] The possibility of gift tax consequences to the beneficiary, however, should not be overlooked.

Potential Gift Tax Problems for the Beneficiary

The beneficiary of a "Crummey" trust may be subject to gift tax liability if he fails to exercise the demand right he holds over additions to the corpus. Under section 2514(c) of the Code, a "Crummey" demand right constitutes a general power of appointment.[73] The exercise or release of a general power of appointment is deemed a transfer of property, and therefore, is subject to gift tax.[74] The lapse of a power of appointment constitutes a release of the power,[75] and as such, is also subject to imposition of the gift tax.[76] Thus, the beneficiary's failure to exercise a "Crummey" demand right may constitute a taxable transfer to the other trust beneficiaries

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would probably qualify for the annual exclusion. See ARIZ. REV. STAT. ANN. §§ 14-5401 to -5410 (1975) setting forth the procedures for appointment of a conservator to receive the property of a minor. Thirty days is probably sufficient time to have a conservator appointed.

70. See Simmons, *Drafting the* Crummey *Power*, 15TH ANN. MIAMI INST. ON EST. PLAN. ¶ 1708, at 17-18 to -26 (1981) for a detailed explanation of the notice requirement. *See also* Schlenger & Reynolds, *Current tax developments: Trust beneficiary with powers to demand withdrawal of principal from trust does not possess a present interest where he was not timely notified of his withdrawal right. Ltr. Rul. 7946007, 7/26/79*, 7 EST. PLAN. 112, 114 (1980); 152 IRS LETTER RUL. RPTR. (CCH) 8003033 (Oct. 23, 1979); 135 IRS LETTER RUL. RPTR. (CCH) 7939061 (June 27, 1979). In 142 IRS LETTER RUL. RPTR. (CCH) 7946007 (July 26, 1979), the Service stated that since the adult beneficiary was not informed of his demand right and was not given sufficient time in which to exercise it (only two days), the donee did not have the right to immediate enjoyment of the trust property and the gift did not qualify for the annual exclusion. *See also* Rev. Rul. 81-7, 1981-1 C.B. 474. *But see* Christensen, *supra* note 47, at 68 ("It is debatable . . . whether the Service's position is well-taken" [referring to the requirement of informing an adult beneficiary of the annual demand right]). Also, in 239 IRS LETTER RUL. RPTR. (CCH) 8138170 (June 29, 1981), 239 IRS LETTER RUL. RPTR. (CCH) 8138102 (June 25, 1981), and 234 IRS LETTER RUL. RPTR. (CCH) 8133070 (May 21, 1981), the Service stated that notice must be given if the beneficiaries are unemancipated minors; however, such notice may be given to the parents as natural guardians. The Service has also ruled that, for a trust funded with insurance policies, a single letter to each beneficiary would constitute sufficient notice if the letter set forth the amount of the original contribution, the terms of the demand rights, and the amount and due dates of premium payments. 222 IRS LETTER RUL. RPTR. (CCH) 8121069 (Feb. 26, 1981).

71. Lischer, *supra* note 67, at 18. *See* 219 IRS LETTER RUL. RPTR. (CCH) 8118051 (Feb. 9, 1981); 204 IRS LETTER RUL. RPTR. (CCH) 8103074 (Oct. 23, 1980).

72. *See* Lischer, *supra* note 67, at 18.

73. I.R.C. § 2514(c) (1976) defines a general power of appointment as a "power which is exercisable in favor of the individual possessing the power . . . , his estate, his creditors, or the creditors of his estate."

74. *Id.* § 2514(b) states: "The exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power." *See also id.* § 2501(a)(1) (West Supp. 1982): "A tax . . . is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident."

75. *See id.* § 2514(b), (e) (1976). "The lapse of a power of appointment . . . shall be considered a release of such power." *Id.* § 2514(e).

76. *See id.* § 2501(a)(1) (West Supp. 1982).

or the remaindermen (if either exist),[77] resulting in gift tax liability to the beneficiary.[78]

According to section 2514(e), the lapse of a power of appointment is considered a release of the power only to the extent the property subject to the power exceeds the greater of $5,000 or five percent of the trust assets (a "five and five power").[79] In a "Crummey" trust, this exception provides a safe harbor for the beneficiary when annual additions to the trust do not exceed the greater of $5,000 or five percent of the trust assets.[80] For example, if a beneficiary of a "Crummey" trust fails to exercise his demand right to a trust contribution of $5,000, he will not be subject to gift tax.[81] If, however, a donor transfers $10,000 to a trust with assets valued at less than $200,000, the beneficiary will be subject to gift tax on the amount in excess of the greater of $5,000 or five percent of the trust assets.[82]

The "five and five power" is often used to avoid potential gift tax liability because of its ease of application.[83] A "Crummey" trust can be

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77. *See id.* § 2514 (1976); Leimberg, *supra* note 48, § 42.05, at 42-29 n.56; Lischer, *supra* note 67, at 20.

78. *See* I.R.C. § 2501(a)(1) (West Supp. 1982); Leimberg, *supra* note 48, § 42.05, at 42-29 n.56; Lischer, *supra* note 67, at 20. Such gifts would be future interests, and therefore, not eligible for the annual gift tax exclusion. Leimberg, *supra* note 48, § 42.05, at 42-29 n.56.

Treas. Regs. § 25.2514-3(c)(4) (1958) states that

> where the possessor of a general power of appointment is incapable of validly exercising or releasing a power, by reason of minority, or otherwise, and the power may not be validly exercised or released on his behalf, the failure to exercise or release the power is not a lapse of the power.

Although at first glance this regulation may seem to indicate that a minor's failure to exercise or release a "Crummey" demand right would not result in a taxable transfer, *see* Lischer, *supra* note 67, at 20, it is doubtful the Service would accept this view. Since the present interest concept of a "Crummey" trust is based on the notion that someone is or could be made available to exercise the demand right on behalf of the minor beneficiary, the Service probably would conclude that this regulation is not applicable to a "Crummey" trust. Simmons, *supra* note 70, ¶ 1712.2, at 17-40.

79. I.R.C. § 2514(e) (1976) provides in pertinent part:

> The lapse of a power of appointment . . . during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts:
> (1) $5,000, or
> (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

80. *See id.*; Lischer, *supra* note 67, at 20. Unfortunately, when the amount of the annual gift tax exclusion was increased from $3,000 to $10,000, *see supra* note 4 and accompanying text, no comparable amendment was made to the ceiling amounts in § 2514(e). Lischer, *Gifts to Minors*, 403 TAX. MGMT. (BNA) A-23, 25, C&A-4 (1979 & 9/20/82 amendments). Congress did not believe such amendments were necessary. TAX MGMT. PRIMARY SOURCES SERIES IV (BNA) § 2503, at 10 n.1 (1981).

81. See *supra* note 79 for the text of I.R.C. § 2514(e) (1976).

82. *See* Huff, *The "Five and Five" Power and Lapsed Powers of Withdrawal*, 15TH ANN. MIAMI INST. ON EST. PLAN. ¶ 705.1, at 7-13 (1981). The position of the Service is that the five percent limit does not apply to the trust corpus, but rather, to the amount which is subject to the beneficiary's demand right. Rev. Rul. 66-87, 1966-1 C.B. 217. *See* Leimberg, *supra* note 48, § 42.05, at 42-29, 42-30 n.56; Lischer, *supra* note 67, at 20 n.21. Careful drafting can avoid this problem. The trust instrument should allow the trustee to satisfy the beneficiary's demand out of any of the trust assets. If the trust assets total at least $200,000, the five percent standard applied to the corpus would allow the donor to take advantage of the full $10,000 gift tax exclusion with no gift tax consequences to the powerholder.

83. *See* Huff, *supra* note 82, ¶ 704.2, at 7-9; Leimberg, *supra* note 48, § 42.05, at 42-29 n.56.

drafted so the beneficiary's demand right is specifically limited to the lesser of the amount contributed or the amounts set out in section 2514(e).[84] A grantor who wants greater flexibility, however, can set up the trust without specific limitations on the demand right.[85] The amount subject to the demand right can then be set by the donor when he contributes to the trust.[86] The donor can thereby vary the amount of demand right with each contribution. If the donor limits the demand right to the "five and five power" at the time of contribution, the beneficiary will not be subject to potential gift tax liability on the lapse of the demand right. The grantor is free to contribute an amount in excess of the five and five limits, and still meet the present interest requirement if the beneficiary's demand right is not limited to the "five and five power."[87] The obvious problem is that if the grantor takes full advantage of the annual gift tax exclusion by contributing $10,000, the beneficiary may be subject to gift tax liability if the trust assets are valued at less than $200,000, since five percent of this amount is $10,000.[88] In addition, the section 2514(e) amounts appear to apply to the total of gifts made in one year, rather than to gifts made by an individual donor.[89] Thus, if other individuals also want to make gifts which, cumulatively, would exceed the five and five amounts, the beneficiary may be subject to gift tax.

A grantor who wishes to take full advantage of the annual gift tax exclusion, but wants to avoid potential gift tax problems for the beneficiary, might consider a one-beneficiary trust. If the trust has only one beneficiary and the trust proceeds will eventually go to that beneficiary, then no gift tax liability will be imposed on the lapse of the demand right.[90] Similarly, the lapse will not result in a taxable gift if the beneficiary has the power to appoint the entire trust assets by will or codicil.[91] In that event, the beneficiary retains the power to change the disposition of the trust assets merely by changing his will. The lapse, therefore, does not constitute a complete transfer and will not result in a taxable gift by the beneficiary.[92]

Several problems are inherent in the one-beneficiary trust. A major problem is that if the beneficiary dies intestate,[93] the trust property will generally revert to the parent,[94] thus frustrating one of the purposes for

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84. S. SURREY, *supra* note 9, at 684.
85. Simmons, *supra* note 70, ¶ 1704, at 17-7 to -8.
86. *Id.*; *see also* 152 IRS LETTER RUL. RPTR. (CCH) 8003033 (Oct. 23, 1979) (donor may instruct trustee that certain donees do not have demand right to particular contributions); Leimberg, *supra* note 48, § 42.05, at 42-33.
87. Simmons, *supra* note 70, ¶ 1704, at 17-7 to -8.
88. *See supra* note 82 and accompanying text.
89. Huff, *supra* note 82, ¶ 707.3, at 7-26 to -27; Leimberg, *supra* note 48, § 42.05, at 42-29 n.56.
90. 243 IRS LETTER RUL. RPTR. (CCH) 8142061 (July 21, 1981); Leimberg, *supra* note 48, § 42.05, at 42-29 n.56; Lischer, *supra* note 67, at 20.
91. 282 IRS LETTER RUL. RPTR. (CCH) 8229097 (Apr. 22, 1982). *See* Treas. Reg. § 25.2511-2(b) (1958).
92. 282 IRS LETTER RUL. RPTR. (CCH) 8229097 (Apr. 22, 1982). See *supra* note 1 for the definition of a "complete" transfer.
93. *See supra* note 21.
94. ARIZ. REV. STAT. ANN. § 14-2103(A)(2) (Supp. 1982-83). The trust property will revert to the parents if the minor dies without a surviving spouse or issue. *Id.*

establishing the trust.[95] In addition, if the beneficiary dies before the trust assets are distributed, the entire trust corpus will be included in the beneficiary's gross estate[96] and the estate will be subject to administration or probate. Finally, if the grantor has more than one child, a separate trust for each child will multiply the trustee's commissions, fiduciary income tax returns, lawyers' fees and paperwork. A trust with multiple beneficiaries or remaindermen would avoid these problems, but may subject the beneficiaries to gift tax liability if trust contributions exceed the five and five limits.[97]

A possible way to avoid the gift tax problems would be to allow the beneficiary to partially release the general power of appointment so the beneficiary can still appoint the assets among a limited class of beneficiaries not including himself.[98] The release of a general power of appointment under those circumstances would not constitute a completed gift because the powerholder has retained the right to appoint among the beneficiaries.[99] The gift would not be complete until the trust terminates or the limited power is exercised or released.[100] Although this might avoid imposition of the gift tax, the property subject to the lapsed powers may be taxed in the beneficiary's estate if the beneficiary dies before the trust terminates.[101]

In sum, the beneficiary of a "Crummey" trust may be subject to gift tax liability if the annual trust contributions exceed the five and five limits of section 2514(e). Donors who want to take full advantage of the annual gift tax exclusion may want to consider creating a one-beneficiary trust. Before making this decision, the donor should weigh carefully the advantages of limiting his annual contributions against the problems inherent in a one-beneficiary trust.

Income Tax Ramifications

Section 641 of the Code imposes a tax on trust income.[102] This tax generally is computed in accordance with sections 651 through 662 of the

95. *See infra* note 170 and accompanying text.

96. I.R.C. § 2033 (1976) includes in the gross estate all property in which the decedent has an interest.

97. *See supra* notes 79-82 and accompanying text.

98. Treas. Reg. § 25.2514-3(c)(1) (1958) provides as follows:

> [I]f a general power of appointment is partially released so that thereafter the donor may still appoint among a limited class of persons not including himself the partial release does not effect a complete gift, since the possessor of the power has retained the right to designate the ultimate beneficiaries of the property over which he holds the power and since it is only the termination of such control which completes a gift.

99. *Cf. id.*; *id.* § 25.2511-2 (1958 & T.D. 7238, 1973-1 C.B. 544, 565-66). *See* Schlenger & Reynolds, *Current tax development: Annual lapse of general power of appointment by holder of withdrawal right in irrevocable trust in excess of $5,000 ruled not subject to gift tax. Ltr. Rul. 8142061*, 9 EST. PLAN. 44, 46 (1982). See estate tax consequences discussed *infra* text accompanying notes 141-63.

100. Schlenger & Reynolds, *supra* note 99.

101. I.R.C. § 2036(a) (Supp. IV 1980) includes in the decedent's gross estate the value of property in which the decedent has retained the right to appoint the person(s) who will possess the property. *See also* Treas. Reg. § 20.2041-3(d)(1) (1958). See estate tax consequences discussed *infra* text accompanying notes 141-63.

102. I.R.C. § 641(a) (West Supp. 1982) states in part: "The tax imposed by section 1(e) shall

Code and allocated between the trust and its beneficiaries.[103] If, however, the grantor or another person is deemed to be the "owner" of any portion of the trust,[104] all of the income from that portion is includible in the owner's taxable income.[105] Section 678 of the Code causes the holder of a demand right to be the owner of the portion of the trust subject to the right.[106] This provision is superceded, however, if the grantor is treated as the owner under Code sections 671 through 677.[107]

Generally, the grantor is treated as the owner of a trust only if he retains one or more of the following:[108]

1. A reversionary interest in the trust that is expected to take effect within ten years;[109]
2. A power to exercise control over the beneficial enjoyment of the trust corpus or income;[110]

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apply to the taxable income . . . of any kind of property held in trust . . . ." I.R.C. §§ 641 through 668 set forth the rules regarding taxation of trust income.

103. *See id.* §§ 651-662 (1976).

104. *See id.* §§ 671-678 (1976 & West Supp. 1982). *Id.* § 671 (1976) provides in pertinent part:

> Where it is specified in this subpart that the grantor . . . shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor . . . those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual.

105. *Id.* § 671; Treas. Regs. §§ 1.671-2(a), -3(a) (1960 & T.D. 6989, 1969-1 C.B. 168, 182).

106. I.R.C. § 678(a) (1976) provides:

> A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
>
> (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
>
> (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject to [sic] grantor of a trust to treatment as the owner thereof.

107. *Id.* § 678(b) (West Supp. 1982) provides: "Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust . . . is otherwise treated as the owner under the provisions of this subpart other than this section."

A question exists regarding the application of this subsection. It provides an exception to the general rule of subsection (a) "with respect to a power over *income*." *Id.* (emphasis added). Most "Crummey" trusts, however, contain powers over principal. Although at first glance this subsection appears inapplicable to most "Crummey" trusts, the legislative history and letter rulings indicate otherwise. The committee reports state: "A person other than the grantor may be treated as the substantial owner of a trust if he has an unrestricted power to take the trust principal or income . . . unless the grantor himself is deemed taxable because of such a power." H.R. REP. No. 1337, 83d Cong., 2d Sess. 63, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4023, 4089-90; S. REP. No. 1622, 83d Cong., 2d Sess. 87, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4629, 4719. More recently, two letter rulings involving powers over trust contributions indicated that the grantor, if treated as owner of a portion of the trust, would be accountable for the income on that portion. 193 IRS LETTER RUL. RPTR. (CCH) 8044080 (Aug. 11, 1980); 156 IRS LETTER RUL. RPTR. (CCH) 8007080 (Nov. 26, 1979). Evidently, then, this subsection's reference to a "power over income" is a drafting error and seems to apply to both powers over income and over principal. *See* Simmons, *supra* note 70, ¶ 1713.2, at 17-42 to -43.

Sections 671-677 of the Code are referred to as the grantor trust rules or "Clifford" rules because they were promulgated in response to Helvering v. Clifford, 309 U.S. 331 (1940). G. BOGERT, *supra* note 28, § 268.15, at 512; DRAFTING CALIFORNIA TRUSTS, *supra* note 16, § 7.87, at 58.

108. Treas. Regs. § 1.671-1(a)(1) to -1(a)(5) (1960 & T.D. 7148, 1971-2 C.B. 251, 252); G. BOGERT, *supra* note 28, § 268.15, at 513.

109. I.R.C. § 673 (1976).

110. *Id.* § 674.

3. An administrative power which allows the grantor to control the trust for his own benefit;[111]

4. The power to revest title in himself;[112] or

5. The power to direct the use of the income for his own benefit or the benefit of his spouse.[113]

The grantor will also be subject to income taxation on account of trust corpus or income actually used for the "support or maintenance of a beneficiary . . . whom the grantor is legally obligated to support."[114]

To avoid grantor trust status, the trust instrument should provide that the trustee can use trust funds for the support of a dependent beneficiary only if the grantor is unable to fulfill his obligations.[115] If the trust avoids classification as a grantor trust under sections 671 through 677 of the Code, the income tax liability will be shifted to the trust and/or its beneficiaries. Shifting the tax liability is desirable where both the trust and its beneficiaries are in lower tax brackets than the grantor.

A beneficiary with a demand right over the entire corpus would take into account all the trust income, and the deductions and credits attributable thereto, in computing his income tax liability.[116] A "Crummey" demand right, however, is generally limited to the amount of the grantor's contribution.[117] Thus, the beneficiary's ownership of the trust under section 678 would be limited to that proportion which the annual demand right bears to the entire trust corpus.[118] For example, if the beneficiary had a right to demand $10,000, and the value of the trust (including the addition) was $100,000, the beneficiary would be the owner of ten percent of the trust for purposes of section 678. He would thus be accountable only for ten percent of the trust income.[119] More difficult questions arise where the trustee has a discretionary power to distribute income among several beneficiaries. A beneficiary with a demand right over a portion of the corpus may be accountable for a proportionate share of the trust income, even though the income is accumulated or distributed to the other beneficiaries.[120] In addition, the beneficiary may be deemed to have gifted his share of the income to the other beneficiaries if all the income is dis-

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111. *Id.* § 675.
112. *Id.* § 676.
113. *Id.* § 677 (West Supp. 1982).
114. *Id.* § 677(b).
115. *See id.*; 184 IRS LETTER RUL. RPTR. (CCH) 8035067 (June 6, 1980).
116. *See* Treas. Regs. § 1.671-3(a)(1) (1960); G. BOGERT, *supra* note 28, § 268.20, at 531.
117. *See, e.g.*, *supra* text accompanying note 52.
118. Treas. Reg. § 1.671-3(a)(3) (1960); *see* I.R.C. § 678 (1976 & West Supp. 1982); Rev. Rul. 67-241, 1967-2 C.B. 225; G. BOGERT, *supra* note 28, § 268.20, at 531-32; Lischer, *supra* note 67, at 18-19.
119. But see *infra* notes 124-28 and accompanying text regarding whether the beneficiary's income portion increases each year, and *infra* notes 129-31 and accompanying text regarding limiting the beneficiary's income portion based on the length of time the demand right is held. The income would also include the trust's capital gains attributable to the portion of the trust owned by the beneficiary. Treas. Reg. § 1.671-3(a)(3) (1960).
120. I.R.C. § 678(a) (1976); Treas. Regs. § 1.678(a)-1 (1960); G. BOGERT, *supra* note 28, § 268.20, at 532; Natbony, *supra* note 48, at 500. See Rev. Rul. 67-241, 1967-2 C.B. 225, where the trust beneficiary with a "five and five power" over the trust corpus was held to be the owner of a portion of the trust corpus even though the income was payable to her sons.

tributed to them.[121] The question whether the beneficiary would be liable for both income tax and gift tax in this situation has not been addressed by the courts. One obvious way to avoid the gift tax problem is to name only one beneficiary under the trust.[122] If that beneficiary is given a demand power over trust contributions, the income tax liability will be shared by the beneficiary and the trustee.[123]

Another question concerning the income taxation of a "Crummey" trust is whether the portion taxed under section 678 increases each year.[124] For example, if the trust contains $20,000 and the beneficiary fails to exercise a demand right over two successive annual contributions of $10,000 each, would the portion taxed under section 678 at the end of the second year be twenty-five percent ($10,000/$40,000) or fifty percent ($20,000/$40,000)? Section 678(a)(2) provides that a person who has released a power over any portion of a trust shall be treated as the owner of that portion if, after the release, such person retains control that would subject a grantor to taxation under sections 671 through 677 of the Code.[125] Consequently, if, after the lapse of a demand right, the powerholder could be treated under one of the provisions of sections 671 through 677 as owner of the trust property that had been subject to the demand right, the portion taxed under section 678 would increase each year.[126] For example, if the trustee had discretion to pay out or accumulate the trust income for the beneficiary, then section 677 might apply to treat the beneficiary as the owner,[127] causing the portion taxed under section 678 to increase. This question, however, is not considered in the Treasury regulations and has not been judicially resolved.[128]

121. G. BOGERT, *supra* note 28, § 268.20, at 532. Treas. Reg. § 25.2514-3(e) Ex. 5 (1958) seems to support the proposition that the lapse of a power of appointment over corpus may constitute a gift of the income to the other beneficiaries. In that example, the Treasury Department states that the lapse of a general power of appointment over the corpus may be a transfer of property when the trust also has an income beneficiary. *Id.*

122. *See supra* text accompanying notes 90-97.

123. *See supra* notes 117-19 and accompanying text.

124. Lischer, *supra* note 67, at 19.

125. I.R.C. § 678(a)(2) (1976); Treas. Regs. § 1.678(a)-1(a) (1960).

126. *See* I.R.C. § 678(a)(2) (1976); Lischer, *supra* note 67, at 19.

127. Huff, *supra* note 82, ¶ 706.2, at 7-22. *See* I.R.C. §§ 677, 678(a)(2) (1976 & West Supp. 1982).

128. Lischer, *supra* note 67, at 19. The possibility of an increase in the ownership interest assumes that the lapse of a "Crummey" power is equivalent to the release of such a power. However, subsection 678(a)(2) may not apply to the lapse of a power. That subsection treats as an owner a person who has partially released or modified a power to vest the trust corpus or income in himself. I.R.C. § 678(a)(2) (1976). One author has suggested that the positive act of releasing or modifying such a power is not the same as the passive act of allowing the power to lapse. Simmons, *supra* note 70, ¶ 1713.4, at 17-45. Another author explains that, under the common law doctrine of "relation back," the powerholder should not be treated as a grantor on the lapse of the power. Huff, *supra* note 82, ¶ 706.2, at 7-22 to -23. Huff states that the doctrine of "relation back" traces the general power of appointment from the creator of the power to the ultimate appointee, thus bypassing the possessor of the power. *Id.* at 7-23. Since neither the Code sections nor the regulations address the question of a lapse under § 678(a)(2), the common law may be applicable. In addition, one might argue that since §§ 2041(b)(2) and 2514(e) specifically equate a lapse of a power of appointment with a release of such power, the failure to refer to a lapse in § 678(a)(2) may indicate that Congress did not intend to treat a lapse as a release. If § 678(a)(2) does not apply to the lapse of a power of appointment, then the powerholder's ownership interest will not increase with every lapse of the power.

Alternatively, it has been argued that a lapse should constitute a transfer in the § 678 income

A possible limitation on the income taxation of the "Crummey" demand right is the length of time the demand right is held by the beneficiary.[129] If the demand right is limited to thirty days from the date of the addition, it is possible that the holder of the right would be considered the owner of that portion of the trust for only that amount of time.[130] Therefore, the beneficiary would be accountable for only that proportion of the trust income equal to the percentage of the trust owned by the beneficiary multiplied by a fraction the numerator of which is the number of days the demand power was held and the denominator of which is 365.[131] In most instances, therefore, the trust income will be split between the beneficiary and the trust itself[132] with the beneficiary being accountable only for a small percentage of the income.[133] This result occurs only where the beneficiary's demand right is exercisable against the annual contributions to the trust; a different result should ensue if the beneficiary were given a demand right over the income of the trust.[134]

In Revenue Ruling 81-6, the Service discussed whether a minor beneficiary with the power to withdraw the entire income of a trust would be treated as the owner of any portion of the trust under section 678.[135] The Service found that, although the minor beneficiary was legally incapable of exercising the power (because no legal guardian had been appointed), this incapacity did not affect the existence of the power.[136] The Service also found that, for purposes of section 678, the existence of the right to withdraw the income, not whether the beneficiary has the capacity to exercise the right, determines ownership.[137] Thus, it is clear that the Service

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tax context as it does in the estate and gift tax areas. Natbony, *supra* note 48, at 501-03. Natbony bases his argument on case law that preceded the enactment of the Clifford regulations (§§ 671 through 677) and the unlimited scope of the § 2514(b) definition of lapse. *Id.* In addition, the Service has indicated its position in Letter Ruling 8142061 that § 678(a)(2) includes a lapse. 243 IRS LETTER RUL. RPTR. (CCH) 8142061 (July 21, 1981). The Service ruled that if the minor beneficiary

> fails to exercise the power to vest in himself any new property which is transferred by gift to the trust, it will become a permanent part of the corpus of the trust. Because the income of that portion, in the discretion of a nonadverse party without the consent of an adverse party, may be distributed to [the minor beneficiary] or accumulated for future distribution to [the minor beneficiary], [the minor beneficiary] will be treated as the owner of that portion of the trust . . . . Sections 671 and 677 of the Code.

Id.

129. *See supra* notes 68-69 and accompanying text; *see also* 243 IRS LETTER RUL. RPTR. (CCH) 8142061 (July 21, 1981) which states: "The calculation of such pro rata share [of income] should take into account the length of time during which [the minor beneficiary] has the power to vest in himself the additions of corpus to the trust . . . ."

130. *See* I.R.C. § 678 (1976 & West Supp. 1982); Lischer, *supra* note 67, at 19.

131. Lischer, *supra* note 67, at 19; *see* 243 IRS LETTER RUL. RPTR. (CCH) 8142061 (July 21, 1981).

132. *See* I.R.C. § 641(b) (West Supp. 1982); G. BOGERT, *supra* note 28, § 268, at 492.

133. *See supra* notes 118-19 and accompanying text.

134. *See* Rev. Rul. 81-6, 1981-1 C.B. 385; 184 IRS LETTER RUL. RPTR. (CCH) 8035067 (June 6, 1980); Kaney, *New ruling taxes minor with Crummey-type power over income from trust*, 8 EST. PLAN. 10, 10 (1981).

135. Rev. Rul. 81-6, 1981-1 C.B. 385.

136. *Id.*

137. *Id.* The Service relied on Trust No. 3 v. Commissioner, 285 F.2d 102 (7th Cir. 1960), for the proposition that a minor beneficiary could be treated as the owner of the trust even though the demand right could not be exercised until a legal guardian was appointed. Rev. Rul. 81-6, 1981-1 C.B. 385. The court in *Trust No. 3* reasoned that "such routine steps [as appointment of a guard-

will consider a minor to be the owner of the income portion of a trust even though no guardian has been appointed.[138] Giving the minor beneficiary a "Crummey" demand right over the income of the trust shifts the entire income tax burden from the trust to the beneficiary.[139]

Tax savings may result if the child, rather than the trust, is taxable on trust income because of a lower tax bracket and a higher exemption for the child.[140] The grantor should be reminded, however, that the beneficiary might exercise the right to demand the income. If the annual income is substantial, this possibility may not be acceptable to the grantor.

Several questions regarding the income taxation of a "Crummey" trust remain unanswered. Generally, it is unclear what proportion of the trust income will be taxed to the beneficiary. Also, the issue whether the beneficiary will be liable for gift tax on the income paid out to other trust beneficiaries has not been resolved. The drafter, therefore, should carefully consider these questionable areas before implementing a "Crummey" trust.

Estate Tax Consequences

In most instances, the "Crummey" trust will provide for distribution of the trust property when the beneficiary reaches an age that the parent considers appropriate.[141] If the beneficiary lives beyond the termination of the trust, use of the trust obviously has no estate tax consequences.[142] If the beneficiary dies prior to the termination of the trust and the trust property is paid to the beneficiary's estate, the trust property will be included in the beneficiary's gross estate pursuant to section 2033 of the Code.[143] Estate tax consequences may also arise where the trust continues after the death of the beneficiary or where the trust property is distributed to a third party at the beneficiary's death.[144]

If the trust property is distributed to a third party upon the death of the beneficiary, section 2041 of the Code will include in the beneficiary's

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ian] would have no bearing upon the fundamental question of the legal right of the beneficiaries to terminate the trust." 285 F.2d at 106.

138. *See also* 184 IRS LETTER RUL. RPTR. (CCH) 8035067 (June 6, 1980) (involving a trust instrument giving a minor beneficiary a noncumulative right to demand the annual income of the trust).

139. Capital gains allocable to corpus that is subject to a minor's demand right would also be taxable to the minor. *Id.*

140. Kaney, *supra* note 134. The following example is applicable:

> For example, if it is assumed that annual contributions of $18,000 compounded, net, at 10% will be accumulated from age 1 through age 20, then at age 21 a fund of approximately $45,000 will have been saved if the child . . . has no other unearned income. This income tax advantage might be enhanced if the yield of the gift were increased by adding income splitting techniques.

Id. at 10.

141. See, for example, 184 IRS LETTER RUL. RPTR. (CCH) 8035067 (June 6, 1980), wherein the trust provided for staggered distributions of one-third of the trust property when the beneficiary reached the ages of 25, 30 and 35.

142. Lischer, *supra* note 67, at 22.

143. I.R.C. § 2033 (1976). *See* Treas. Reg. § 20.2041-1(b)(2) (1958): "The power of the owner of a property interest already possessed by him to dispose of his interest . . . is includible in his gross estate to the extent it would be includible under section 2033 . . . ."

144. Lischer, *supra* note 67, at 20.

gross estate the value of any demand right held at the time of death[145] and may also include the value of the demand rights that have lapsed in prior years.[146] Thus, if the trust instrument provides that the beneficiary has a demand right over additions to the trust for a period of thirty days,[147] and the beneficiary dies during that period, the value of the property subject to the demand right is included in the beneficiary's gross estate.[148] The Service maintains that this rule applies even though the beneficiary is a minor who is incapable of exercising the power.[149] Recent case law has supported the Service's position[150] and has generally held that property subject to a power of appointment will be included in the gross estate even though the powerholder was incompetent.[151] Section 2041 may also apply to lapses of general powers of appointment that occurred in years prior to the beneficiary's death, where the property subject to the power remained, after the lapse, in a status that would have caused its inclusion under any of Code sections 2035 through 2038 if the beneficiary had transferred the property directly.[152] The applicability of sections 2035 through 2038 must therefore be considered.

For example, under section 2036, the gross estate includes the value of property transferred by the decedent if he retains the right to the income therefrom.[153] Section 2041(a)(2), in effect, causes a lapse of a general power of appointment to be deemed a transfer for purposes of sections 2035 through 2038.[154] Consequently, if the beneficiary has an income interest in the trust and allows a general power of appointment to lapse, the property subject to that power will be included in his gross estate.[155]

In any event, property is included in the gross estate only to the extent that the lapsed power of appointment exceeds the greater of $5,000 or five

145. I.R.C. § 2041(a)(2) (1976). Section 2041 provides that the value of property subject to a general power of appointment is included in the powerholder's gross estate. This section defines a "general power of appointment" as "a power which is exercisable in favor of the" powerholder. I.R.C. § 2514(c) (1976). Thus, a "Crummey" demand right falls within this section.

146. *Id.* § 2041(a)(2). This section provides that the gross estate of the decedent includes the value of all property with respect to which the decedent released a general power of appointment thereby allowing the property to continue being held in a fashion that would have resulted in the property's inclusion under §§ 2035 through 2038 if the decedent had made the transfer directly. *Id.* The lapse of a general power of appointment constitutes a release of such power, but only to the extent that the property affected by the lapsed power exceeds the greater of $5,000 or five percent of the value of the assets out of which the power could have been satisfied. *Id.* § 2041(b)(2).

147. *See supra* text accompanying notes 68-69.

148. I.R.C. § 2041(a)(2) (1976).

149. Rev. Rul. 75-351, 1975-2 C.B. 368.

150. Estate of Rosenblatt v. Commissioner, 633 F.2d 176 (10th Cir. 1980); Fish v. United States, 432 F.2d 1278 (9th Cir. 1970).

151. *See* Boeving v. United States, 650 F.2d 493 (8th Cir. 1981); Williams v. United States, 634 F.2d 894 (5th Cir. 1981); Estate of Alperstein v. Commissioner, 613 F.2d 1213 (2d Cir. 1979).

152. I.R.C. § 2041(a)(2), (b)(2) (1976). Section 2041(b)(2) states that the "lapse of a power of appointment . . . shall be considered a release of such power." *Id.* § 2041(b)(2). Section 2041(a)(2) provides that the gross estate shall include the value of property "with respect to which the decedent has . . . released such a power of appointment by a disposition [that would have caused inclusion] under sections 2035 to 2038." *Id.* § 2041(a)(2).

153. *Cf. id.* § 2036(a)(1) (Supp. IV 1980).

154. *See id.* § 2041(a)(2) (1976).

155. See examples set forth in S. SURREY, *supra* note 9, at 535.

percent of the assets subject to the power.[156] The amount included is determined by multiplying the date of death value of the trust property[157] times a percentage computed for each year a taxable lapse occurred.[158] That percentage is determined by comparing each taxable lapse with the total value of the trust property at the end of that year.[159]

For example, if an income beneficiary fails to exercise a demand right over a $10,000 addition to the trust corpus, a portion of this amount might be included in his gross estate.[160] Assuming the total value of the trust property at the end of the year in which the lapse occurred was $100,000, the percentage thereof potentially subject to estate tax would be five percent—the ratio of $5,000 ($5,000 of the $10,000 lapsed power is excluded pursuant to section 2041(b)(2))[161] to $100,000. If a taxable lapse of $10,000 occurred in a subsequent year in which the total value of the trust property was $120,000, the resulting percentage would be 3.33%—$4000 divided by $120,000. Six thousand dollars—five percent of the trust assets—is excluded pursuant to section 2041(b)(2). The sum of the percentages for each year in which a taxable lapse occurred would then be multiplied by the estate tax value of the trust property to determine the amount includible in the beneficiary's gross estate under section 2041. In this example, if the estate tax value of the trust property were $200,000, such amount would be multiplied by the sum of the percentages calculated for the years in which lapses occurred (5% plus 3.33%): $200,000 x 8.33%. Thus, $16,660 would be includible in the gross estate of the income beneficiary.[162]

If the beneficiary and/or his or her estate are the only trust beneficiaries, section 2041 will not apply to lapses of the beneficiary's demand right,[163] and the calculations just described will not be necessary. Such calculations will, however, be necessary in the bulk of cases in which a

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156. I.R.C. § 2041(b)(2) (1976) states:

> The lapse of a power of appointment . . . during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts:
>
> (A) $5,000, or
>
> (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

157. Treas. Regs. § 20.2041-3(d)(4) (1958).

158. *Id.*

159. *Id.*

160. *See* I.R.C. §§ 2036, 2041 (1976 & Supp. IV 1980). Sections 2041(a)(2) and 2036(a)(1) operate together to include in the gross estate the value of property subject to a power of appointment which the decedent has exercised, released or allowed to lapse, and in which he has retained an income interest.

161. See *supra* note 156 for the text of § 2041(b)(2). Subsection 2041(b)(2)(B) provides an exempt amount of "5 percent of the . . . assets out of which . . . the exercise of the lapsed powers could have been satisfied." To give this subsection broader scope, the assets available to satisfy the beneficiary's demand should be the entire trust corpus, and not merely the annual contributions. *See* I.R.C. § 2041(b)(2)(B) (1976); Lischer, *supra* note 67, at 22.

162. *See* S. SURREY, *supra* note 9, at 535-36; Huff, *supra* note 82, ¶ 705.2, at 7-16 to -19, for other examples.

163. Lischer, *supra* note 67, at 22. *See supra* notes 145-52 and accompanying text.

"Crummey" demand right holder dies prior to the termination of the trust if there are multiple beneficiaries and the demand right exceeds a "five and five power."

Utility of a "Crummey" Trust

Although there are some disadvantages to a "Crummey" trust, the demand right is a useful estate planning tool.[164] By providing a minor beneficiary with a demand right in trust additions, and by transferring property worth up to $10,000 to the trust each year,[165] a parent can take full advantage of the annual gift tax exclusion.[166] Additionally, as long as the parent does not retain any of the powers set forth in sections 671 through 677 of the Code,[167] and as long as the trust funds are not used to satisfy a legal support obligation of the grantor,[168] the parent will not be subject to income taxation on trust income.[169] Assuming that the parent does not retain any power over or interest in the trust, the trust property is removed from the parent's gross estate.[170] Thus, the grantor can accomplish substantial income, gift and estate tax advantages by making annual transfers to a "Crummey" trust. Such transfers will also result in a sizable fund being distributed to the child at an age chosen by the parent.

Such a trust must be drawn to avoid adverse tax consequences to the minor beneficiary. If the trust has multiple beneficiaries, and a beneficiary dies before the trust terminates, a portion of the trust may be included in the beneficiary's gross estate due to current and lapsed demand rights. Moreover, a beneficiary may be subject to gift taxation on each lapse of the demand right.[171] On the other hand, if multiple beneficiaries are not provided, the entire trust property will not only be subject to estate taxation,[172] but will probably return to the parent if the beneficiary dies while a minor.[173] However, due to the increasing amount of the unified credit,[174]

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164. Kaney, *supra* note 134, at 13.

165. *See supra* notes 4-6 & 58-61 and accompanying text.

166. I.R.C. § 2503(b) (West Supp. 1982). See *supra* note 5 for a discussion of split gifts. Care should be taken in making a split gift. The Service in Letter Ruling 8022048 stated that only half of the total gift qualified for the annual exclusion. 171 IRS LETTER RUL. RPTR. (CCH) 8022048 (Mar. 4, 1980). The rationale was that since the husband and wife did not have to elect the split gift until the due date of the gift tax return, the trustee could not be required to distribute the full amount until the election became finalized. *Id.* This postponement of the enjoyment of the property rendered half of the gift a future interest and therefore ineligible for a double annual gift tax exclusion. *Id.* It is suggested this problem can be avoided by careful drafting of the trust so that the trustee may not distribute until after the consent form is signed. Henszey, Crummey *Power Revisited*, 59 TAXES 76, 78 (1981). Alternatively, the spouse could execute a binding agreement in which she agreed to consent to splitting all future gifts to a particular donee.

167. *See supra* notes 108-13 and accompanying text.

168. I.R.C. § 677(b) (West Supp. 1982).

169. *See supra* notes 108-15 and accompanying text.

170. *Cf.* I.R.C. § 2031 (1976).

171. *See supra* notes 75-92 and accompanying text.

172. *See* Treas. Reg. § 20.2041-1(b)(2) (1958).

173. *See supra* note 21.

174. I.R.C. § 2010(a), (b) (West Supp. 1982). Section 2010(a) provides a credit of $192,800 against the estate tax imposed by section 2001. The amount of this credit is available to the estates of decedents dying in 1987 and later. Subsection (b) provides a phase-in of a lower amount of credit for the estates of decedents dying in 1982 through 1986. For example, the amount of the credit in 1983 is $79,300. *Id.* § 2010(b).

the trust fund may not generate any estate tax in the event of the beneficiary's death.[175] For example, if the beneficiary dies in 1987 and the trust fund and other property owned by the beneficiary total less than $600,000 at the beneficiary's death, no estate taxes would be due.

To avoid an illusory demand right, the trust instrument should require that (1) notice of each addition be given to the beneficiary by the trustee, (2) sufficient liquid assets be maintained to satisfy the demand, and (3) additions be made sufficiently in advance of the lapse of the demand right that a legal guardian could be appointed to exercise the demand right for a minor beneficiary.[176] These provisions are essential to withstand an attack on the trust by the Service. Other provisions should be included based on the needs of the parent/grantor.

For example, a typical "Crummey" trust can be drafted to give the trustee discretion to accumulate income and to distribute both principal and income for the support, maintenance, health and education of each beneficiary, considering other means of support available to the beneficiaries. Adverse gift tax consequences to the beneficiary can be avoided either by creating a separate trust for each beneficiary or by limiting the beneficiary's demand right to the five and five amounts of section 2514(e). Alternatively, the donor can be given the right to designate, at the time of the addition, the amount of the addition subject to the demand right.[177] Any guardian or conservator of the beneficiary should be expressly authorized to exercise the beneficiary's demand rights. The unexpended corpus and accumulated income can be distributed to the beneficiary in stages: for example, one-third at age twenty-five, one-half of the remainder at age thirty, and the balance at age thirty-five.

Under this trust, the donor would be relieved of gift tax liability if the annual additions are $10,000 or less (assuming no other gifts are made to the beneficiary). The donor could remove from his estate substantial amounts of property, thereby saving estate taxes. Also, by transferring income-producing property to the trust, the donor would also reduce his income tax liability. There would be no gift tax consequences for the beneficiary if the trust is either a one-beneficiary trust or the beneficiary's demand right is limited to a "five and five power" in a multi-beneficiary trust (but the parent can take advantage of the annual gift tax exclusion only to the extent of the demand right). The income tax liability would be split between the trustee and the beneficiary, the beneficiary being responsible only for the income attributable to the property subject to his demand right. The trust assets of a one-beneficiary trust would be subject to estate taxation if the beneficiary died prior to termination of the trust. Alternatively, the trust assets could pass to other trust beneficiaries or remaindermen.

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175. See *id.* § 2001(c) for the amounts necessary to generate estate tax and *id.* § 2010(a) & (b) for the applicable credit.

176. *See supra* notes 68-72 and accompanying text.

177. Schlenger & Reynolds, *supra* note 99, at 47. This provision allows the donor to remove certain transfers from the beneficiary's immediate access, as long as the donor is willing to pay the gift tax. *See supra* notes 85-87 and accompanying text.

Where the parent wants to avoid estate taxation on the death of the beneficiary and also wants to avoid the possibility that the property will return to the parent if the beneficiary dies intestate, the trust should have more than one beneficiary. Such a trust may have gift tax consequences for a beneficiary who allows his demand right to lapse, and if the beneficiary has any other interests in the trust, a portion of the trust property may be subject to estate taxation at his death due to lapsed demand rights. Both problems can be avoided by restricting the demand right to the greater of $5,000 or five percent of the trust assets. If the trust corpus totals less than $200,000, however, the donor will not be able, through additions to the trust alone, to take full advantage of the $10,000 annual gift tax exclusion. In any event, the property subject to the demand right exercisable by the beneficiary will be subject to estate taxation at his or her death.

A popular use of the "Crummey" trust is to fund the trust primarily with insurance policies on the life of the grantor.[178] The policies, owned by the trustee, are not subject to estate taxation at the death of the grantor, because the grantor retains no incident of ownership in them.[179] Either term, group term or whole life insurance policies can be transferred to a "Crummey" trust with little or no gift tax liability.[180] Term and group term insurance policies generally have no economic value, so the value of the gift would be only the amount of the unearned premium.[181] The value of the whole life policy is essentially its cash surrender value plus any unearned premium.[182] Consequently, the whole life policy can also be transferred without incurring gift tax liability if its value is less than $10,000. In addition, premium payments may be considered gifts qualifying for the annual exclusion, whether they are paid to the trust or paid directly by the donor or the employer.[183] To obtain this result, the donor can transfer sufficient cash to the trust at the time the policy is transferred to satisfy any demand right exercised by the beneficiary.[184] A grantor who is concerned with the liquidity of his or her estate can provide the trustee with the power to purchase assets from the grantor's estate or the power to make loans to the estate.[185]

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178. *See generally* Friedman, *Estate Planning Strategies Through Life Insurance Trusts Under the 1981 Tax Act*, 60 TAXES 349, 361-64 (1982); Keydel, *Irrevocable Insurance Trusts: The Current Scene*, 10TH ANN. MIAMI INST. ON EST. PLAN. ¶ 508.1, at 5-16 to -21 (1976); Price, *The Uses and Abuses of Irrevocable Life Insurance Trusts*, 14TH ANN. MIAMI INST. ON EST. PLAN. ¶ 1115, at 11-34 to -38 (1980); Ruidl, *Irrevocable but flexible life insurance trust still is an effective tax saver for many*, 56 J. TAX'N 274 (1982); Simmons, *supra* note 70, ¶ 1711, at 17-30 to -36.

179. *See* I.R.C. § 2042 (1976).

180. The Service has indicated its approval of such transfers in several private letter rulings. *See, e.g.*, 239 IRS LETTER RUL. RPTR. (CCH) 8138170 (June 29, 1981); 235 IRS LETTER RUL. RPTR. (CCH) 8134135 (May 28, 1981); 155 IRS LETTER RUL. RPTR. (CCH) 8006109 (Nov. 20, 1979); 143 IRS LETTER RUL. RPTR. (CCH) 7947066 (Aug. 23, 1979).

181. Rev. Rul. 76-490, 1976-2 C.B. 300; Ruidl, *supra* note 178, at 277.

182. Ruidl, *supra* note 178, at 277.

183. *See* 235 IRS LETTER RUL. RPTR. (CCH) 8134135 (May 28, 1981); 170 IRS LETTER RUL. RPTR. (CCH) 8021058 (Feb. 28, 1980); 155 IRS LETTER RUL. RPTR. (CCH) 8006109 (Nov. 20, 1979).

184. See 204 IRS LETTER RUL. RPTR. (CCH) 8103074 (Oct. 23, 1980), in which the Service ruled the beneficiaries had a present interest in the premium payments to the extent there was cash, or assets reducible to cash, in the trust.

185. Ruidl, *supra* note 178, at 279.

Clearly, the "Crummey" trust is a flexible estate planning tool that can be used to accomplish a variety of purposes for both the grantor and the beneficiary. The drafter should be cautious in the use of this type of trust, however, and consider all possible tax consequences to all the parties involved.

Conclusion

A popular method for parents to accumulate a fund for the future use of their minor children while taking advantage of the annual gift tax exclusion is the "Crummey" trust. This trust has become more attractive recently because of the increase in the annual gift tax exclusion from $3,000 to $10,000. The increase has also caused more complex tax issues in the use of the "Crummey" trust. In addition, the Service has issued several letter rulings defining what it believes to be the minimum requirements of a valid "Crummey" trust.

To withstand an attack by the Service, the "Crummey" trust should require the trustee to give the beneficiary notice of the existence of the trust and of every addition to the trust. The beneficiary also should be given sufficient time in which to exercise the demand right—at least thirty days. Another useful provision would require the trustee to maintain sufficient liquid assets in the trust to satisfy all demand rights.

One of the problems of a "Crummey" trust is the application of section 2514. This problem became more significant when the annual gift tax exclusion was increased from $3,000 to $10,000. Under section 2514, the failure to exercise a "Crummey" demand right may constitute a gift to other trust beneficiaries or remaindermen. Similarly, section 2041 may cause inclusion in the beneficiary's gross estate of amounts subject to current, and possibly lapsed, "Crummey" demand rights. Income tax questions arise regarding the proportion of trust income that will be taxed to the beneficiary: whether the amount taxable to the beneficiary will increase each year, and whether the taxable amount is limited because of the length of time the demand right is held by the beneficiary.

Although several potential problems exist, many of these can be minimized or avoided with careful planning. The "Crummey" trust remains a useful estate planning tool and can provide substantial gift, income and estate tax advantages to parents who want to establish a fund for their children's future enjoyment. Other methods of accumulating funds for minor children can provide parents with identical tax advantages. Only the "Crummey" trust permits parents to prevent distribution to the child of the bulk of the trust property until an age past majority, when the parents feel the child will be better able to manage the property. The trust instrument must be carefully drafted, however, to avoid treatment of the demand power as illusory by the Service and to avoid potential adverse tax consequences to the grantor or the beneficiary.