**Take-Away:** The trustee's failure to provide written Crummey withdrawal notices to a trust beneficiary is not a reason to lose sleep.

**Background:** Currently a donor may exclude the first $18,000 of gifts made to each donee during 2024 in determining the total amount of taxable gifts for the year, which is referred to as the federal gift tax *annual exclusion.* [IRC 2503(b).] To qualify for the federal gift tax *annual exclusion,* the gift must be a *present interest.* A gift of a *present interest* requires that the donee has an unrestricted right to the immediate use, possession, or enjoyment of the transferred property, or the income from it. [Regulation 25.2503-3(b).] Most transfers to a trust fail to qualify as a gift of a *present interest* because the donee does not possess an unrestricted right to the immediate use, possession, or enjoyment of the property or its income. Accordingly, to have transfers to a trust qualify as gifts of *present interests,* and thus be eligible for the federal gift tax *annual exclusion,* the trust instrument generally has a provision that gives the trust beneficiary withdrawal rights with respect to the transfers to the trust. The donee is given a relatively short time to exercise his/her withdrawal right before the right lapses, e.g., 30 to 60 days. This withdrawal right held by the trust beneficiary was acknowledged by the Ninth Circuit in *Crummey, 397 F.2d 82 (9th Circuit, 1968)* to constitute a *present interest,* much to the dismay of the IRS.

**IRS Response to *Crummey:*** The IRS did not acquiesce to the *Crummey* decision's conclusion that *a present interest* is satisfied by the beneficiary's withdrawal right. It claims that the beneficiary must have actual notice of the withdrawal right and a reasonable time within which to exercise the right before it lapses. In Revenue Ruling 81-7 the IRS stated that if the beneficiary is not informed of his/her right to withdraw transfers to the trust, the beneficiary's right to immediate possession and enjoyment of the property is postponed, and

in effect the beneficiary receives only a *future* interest at the time the gift is made.

In short, it remains the IRS's position that the beneficiary's power to demand trust corpus does not qualify as a transfer to a trust as a *present interest* that is eligible for the federal gift tax *annual exclusion* if the donor's conduct makes the beneficiary's demand right illusory and it effectively deprives the trust beneficiary of the power. As a result of the IRS's announced position, most trusts to which transfers are intended to qualify for the federal gift tax *annual exclusion* contain a provision that requires the beneficiaries with a withdrawal power be given notice by the trustee of their right to exercise this power. Which, in turn, leads to considerable anxiety when such written notices are not provided by the trustee to the trust beneficiaries when transfers are made to the trust subject to the beneficiaries' withdrawal rights. Such withdrawal notices are commonplace when an irrevocable trust is funded with lifetime *annual exclusion* gifts that are used to pay life insurance premiums owed by the trust, i.e., the classic irrevocable life insurance trust, or ILIT.

**The Question:** Must written *Crummey* withdrawal rights provided to trust beneficiaries be given by the trustee? **Answer: Probably not.**

***Crummey* Notices Are Not Required:** The U.S. Tax Court in *Turner, Tax Court Memo 2011-209,* found that such a notice by the trustee is not required. In that case the decedent created a trust during his life to own life insurance policies on his life for the benefit of his children and grandchildren.

> **Trust Instrument:** The trust instrument provided that, after a direct or indirect transfer to the trust, the trust beneficiaries had the right to withdraw the lesser of (i) the gift tax *annual exclusion* amount, or (ii) the amount of the direct or indirect transfers divided by the number of trust beneficiaries. The trust instrument did not indicate whether the trustees were required to give notice of the withdrawal power to the trust beneficiaries who possesses such power. Three years prior to his death the decedent made premium payments directly to the life insurance companies on the policies owned by the trust. The trust instrument did

provide that upon notice of a trust beneficiary's exercise of his/her withdrawal power, the trustees were authorized to distribute cash or other trust property or to borrow against the cash value of any life insurance policies to obtain cash for the distribution of the requesting trust beneficiary.

**IRS:** The IRS included in the decedent's adjusted taxable gifts for estate tax purposes the premiums paid on the life insurance policies for the three years prior to the decedent's death [IRC 2035(d)] because the payments did not qualify for the federal gift tax *annual exclusion.* The IRS claimed that the beneficiaries' withdrawal rights were illusory for two reasons: (i) the decedent did not deposit money with the trustees but instead paid the life insurance companies directly; and (ii) the trust beneficiaries did not receive notice of the transfers, i.e., notice of the donor's direct payment of the life insurance premiums was not given to the trust beneficiaries.

**Tax Court:** The Tax Court's decision addressed the IRS's arguments, albeit in a very short paragraph.

> **Indirect Transfers:** The Tax Court found that it was '*irrelevant*' that the decedent did not transfer funds directly to the trust. The federal gift tax *annual exclusion* should be allowed for indirect gifts to a trust if the trust has sufficient assets with which to satisfy the withdrawal powers of the trust beneficiaries that arise when a transfer has been made to, or on behalf of, the trust.
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> **Lack of Notice:** Regarding the lack of notice to the trust beneficiaries who possessed the withdrawal powers, the Tax Court found that some or all the trust beneficiaries may not have known they had the power to withdraw sums from the trust *"does not affect their legal right to do so,"* citing *Crummey* as support for this conclusion. **Caveat:** However, *Crummey* did not directly address 'notice' as a requirement for a transfer to a trust subject to a beneficiary's withdrawal power to be a gift of a *present interest* that qualifies for

the federal gift tax *annual exclusion*. In *Crummey,* the focus of that Court was on the beneficiaries' legal right to exercise their withdrawal power, and whether withdrawal powers qualified as gifts of a *present interest;* that Court concluded that the beneficiaries did have such a right, hence the gifts on behalf of the trust (premium payments) satisfied the Tax Code's *present interest* requirement. The provision of the *Crummey* trust giving the beneficiaries a withdrawal power did not contain any formal notice requirement.

***Holland*-Failure to Give Notice:** Yet in an earlier Tax Court case, *Holland, Tax Court Memo, 1997-302* the Tax Court directly addressed the failure of the trustee to give beneficiaries notice of a transfer to a trust which contained withdrawal rights.

**Trust Instrument:** In *Holland,* the trust instrument provided that when a transfer was made to the trust, the trustees were immediately required to give written notice to the trust beneficiaries of their right to withdraw an amount up to the value of any gifts made during the calendar year. Apparently, the trustee failed to comply with that directive.

**IRS:** In challenging the eligibility of the gifts to the trust for the gift tax *annual exclusion,* the IRS argued that the written notice requirement in the trust instrument had not been satisfied, despite the language in the trust instrument.

**Tax Court:** Citing *Crummey,* the Tax Court noted that the sufficiency of a withdrawal notice is a factor to be considered "*in the likelihood that the right of withdrawal will be exercised; it is not a factor in the legal right to demand payment from the trustee.*" Specifically, as to the minor beneficiaries of the trust who were the trustees' children, the court found the failure of the trustees to give written notice to themselves did not require a finding that *"the beneficiaries did not have present interests in the gifts."* As for the adult trust beneficiaries, the court found that although written notice may not

have been given to them, testimony at trial established that they were aware of their withdrawal rights, which gave rise to the gift of *present interests*.

**Upshot:** The *Turner* decision seems to support the argument that a notice requirement is not necessary for transfers to a trust that is subject to withdrawal powers to qualify as a *present interest* gifts. The Tax Court seems to suggest that a trust beneficiary will have a 'real' right even if he/she does not know that he/she has it. As for the *Holland* decision, the notice requirement was a contested issue raised by the IRS, but the Tax Court determined that, based on the facts and testimony at trial, although the written notice requirement of the trust instrument had not been satisfied, the beneficiaries had notice of their withdrawal rights. The IRS has not abandoned its position that written notice must be given each time a transfer is made to a trust with withdrawal rights if the transfer to the trust is to be treated as a *present interest*, but at least *Turner* and *Holland* provide a legal basis to argue that written notice to the trust beneficiaries is not required in order for the gifts to constitute *present interest* gifts.

**Fixing Missing Crummey Withdrawal Notices:** Assume that a trustee has not been vigilant in giving *Crummey* withdrawal notices to trust beneficiaries. While arguments can be made that such notices are not required, citing both *Turner* and *Holland,* other steps might be taken to 'fix' the missing *Crummey* notices.

**Document Any Oral Notices:** If a trust beneficiary received oral notice of the transfer to the trust, have that beneficiary acknowledge in writing that he/she received oral notice for the 'missing' years transfers were made to the trust, yet no written notice was provided to them. The fact that this is done prior to any IRS challenge or audit would demonstrate that it was in fact done in good faith and not in response to an IRS audit. To document this oral notice, the beneficiary should sign a written statement that confirms the date of each gift, the withdrawal right associated with each gift, and the beneficiary's actions with respect to

that withdrawal right.

**File a Late Gift Tax Return Reporting the Gifts:** Assuming no federal gift tax return was filed for the years when gifts were made to the trust that contained a *Crummey* withdrawal right, the donor should file a 'late' federal gift tax return that details the reasons that the *annual exclusion* gifts were allowable. The statute of limitations will close three years after the filing of the US gift tax return with respect to this issue if it is adequately disclosed on the Form 709. [Regulation 301.6501(c)-1(f).]

**Create *Crummey* Withdrawal Rights in the Gift Transfer:** One possible method to secure a gift tax *annual exclusion* where the trust instrument does not even contain a beneficiary withdrawal right provision is to create *Crummey* withdrawal rights in the letter or transfer instrument to the trustee. This letter/transfer instrument would inform the trustee of the gift being made, the terms of the gift, which trust beneficiaries have withdrawal rights, the amount of the withdrawal right, the time in which a withdrawal right lapses, etc. This technique was successfully used to increase an annual withdrawal right from $3,000 to $10,000. [Private Letter Ruling 8445004.] The same letter technique might be used, now that the gift tax *annual exclusion* amount is periodically adjusted to reflect inflation, if the 'old' trust instrument 'locks-in' the beneficiary's withdrawal amount tied to a much lower gift tax *annual exclusion* amount, e.g., $3,000 in past years.

**Analogies Under Tax Code Sections:** If the donor is audited, then perhaps the donor should raise an argument, by analogy to other Tax Code sections, where the possession of a right 'trumps' knowledge of that right. For example, both IRC 2041(a) and IRC 2503(c)(2) include in the decedent's estate a general power of appointment over property interests. The mere possession of that general power of appointment will trigger estate inclusion under IRC 2041(a) regardless of whether the holder of the general power of appointment was competent to exercise that power. In short, the theory underlying the treatment of a general power of appointment is analogous to the theory that the existence of the

legal right to withdraw the contribution to the trust, and not the notice of or appointment of a guardian or conservator for a minor, incompetent or disabled beneficiary, is what creates a *present interest* and allows the donor to use the federal gift tax *annual exclusion*. In short, the IRS's insistence on a written notice of a withdrawal right is not part of the Tax Code before the *right of withdrawal* is respected for tax treatment, just like other provisions of the tax code, where holding the *right* dictates tax consequences even when there is no knowledge of the *right*..

**If Audited, Cite *Crummey and Holland:*** If audited by the IRS due to a 'missing' *Crummey* notice, the donor should argue that the existence of the withdrawal right was itself sufficient to confer a *present interest* status on a contribution to an irrevocable trust. The Tax Court never required written notice, verbal notice, or other notice be given to the trust beneficiaries. Point to the Tax Court's observation that it was unlikely that certain beneficiaries would ever know of the contribution, when it said: "*It is likely that some, if not all, of the beneficiaries did not even know that they had any right to demand funds from the trust. They probably did not know when contributions were made to the trust or in what amount.*"

**The Future?** Treasury's recent 2025 Budget Proposal would lead to a major overhaul of *annual exclusion* gifts by donors. First, rather than an $18,000 limit per donee for an unlimited number of donees, the donor would be limited to a total of $50,000 *annual exclusion* gifts for the entire calendar year. Second, relevant to the above discussion, the donor's *annual exclusion* gifts would no longer be required to be that of a *present interest,* which would have the effect of eliminating the entire need for conferring withdrawal rights on trust beneficiaries, or the need to provide notice to the trust beneficiaries of their ability to make withdrawals from the trust.

**Conclusion:** The IRS continues to take the position that a transfer to an irrevocable trust with beneficiaries who hold withdrawal powers must be accompanied by a timely written notice to the beneficiaries of their right of withdrawal within the reasonable period in which to exercise that right. The Tax

Court takes the position, at least in two opinions, that such a written notice is not required for the donor's transfers to the trust constitute a *present interest*. Professional trustees are pretty good at following through with notices to trust beneficiaries to alert them of the transfer to the trust and the exercise of their withdrawal rights; individual trustees are not so vigilant when it comes to giving notice to trust beneficiaries and maintaining trust records of the timely notice of withdrawal rights. Failing to give a notice of a withdrawal right is probably not fatal, but giving notice is something to remember nonetheless.

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