

Annual Exclusion Gifts- Remember the Present Interest Requirement

Take-Away: The federal gift tax annual exclusion is not nearly as straightforward as some individuals think.

Background: We know that the federal gift tax annual exclusion amount is currently \$19,000 per donee in 2026. Despite prior proposals in Congress to either lower the annual exclusion amount or to restrict the number of donees eligible to receive an annual exclusion gift from the same donor in a single calendar year, the exclusion remains at \$19,000 per donee, thus making it a powerful tool to implement the transfer of wealth, considering that a married couple could gift up to \$38,000 in 2026 to a single donee without having pay a gift tax or file a federal gift tax return. However, often overlooked when discussing the advantages of an annual exclusion gift is the requirement that the gift must be a *present interest*, which in turn can present problems for certain types of property that are the subject of the gift. Additionally, there are other complicated rules that have to be satisfied if the gift is made to a donee who is a *skip person* for generation skipping transfer tax (GSTT) purposes.

Carryover Basis Considerations: Mitigating against making a lifetime gift and exploiting the gift tax protection afforded by the annual exclusion opportunity is that a lifetime gift results in a carryover income tax basis in the hands of the donee. [IRC 1015.] As such, with the decision whether to make a lifetime gift and exploit the federal gift tax annual exclusion, a donor will have to balance the expected benefit of removing the gifted asset (and any future appreciation) from his/her gross estate with the potential capital gain tax cost that will result from the loss of any basis adjustment on the donor's death. With a \$15 million applicable exemption amount available to most donors (or \$30 million if the donor is married and a portability election is made for the survivor) avoiding federal estate taxes is not a big issue for almost all US citizens. [Aside: If the donor pays a gift tax on the transfer of appreciated property, above the annual exclusion amount, the donee's tax basis in the gifted asset is increased by the portion of the gift tax attributable to the appreciation in the property. Regulation 1.1015-5(c).] With a carryover basis the prospective donor needs to consider the amount of the appreciation in the property to be given and the likelihood of a sale in the near future by the donee.

Scope of Exclusion: The Tax Code permits gifts, other than gifts of a *future interest* in property, to qualify for the federal gift tax annual exclusion. [IRC 2503(b.) A qualifying gift may be made to any person (i) without incurring federal gift tax or possibly the generation skipping transfer (GST) tax; (ii) without eroding the donor's lifetime applicable exemption amount [IRC 2505]; and (iii) without requiring, to avoid the GST tax on a transfer to a *skip person* who is a natural person [IRC 2613(a)] or a certain type of trust for the exclusive benefit of such person [IRC 2642(c)(2)] allocated by the donor using the donor's GST exemption. [IRC 2503(b) and IRC 2642(c).] More on the GST exemption below.

Present Interest Limitation: *Present interest* is defined as the unrestricted right to the immediate use, possession, or enjoyment of the property or the income from the property that is the subject of the gift. [Regulation 25.2503-3(b).] Accordingly, a gift of cash or property directly to a child by the donor will qualify for the federal gift tax annual exclusion because the donee will have the immediate use, possession or enjoyment of the property that was gifted.

Trump Accounts: However, consider the 'new' Trump Account that can be opened and funded by a donor starting on July 4, 2026. A Trump Account is intended to hold its investments and earnings until the child-beneficiary attains the age 18, without access to that account during this 'growth period.' Congress apparently forgot to provide in IRC 530A, like with a 529 higher education account, that a contribution to a Trump Account will nonetheless qualify for the federal gift tax annual exclusion, because the gift is, in effect, a gift to a trust where the beneficiary does not possess the right to possess, enjoy, or receive the income from the account. [Hence the result of having to hurry to enact the One Big Beautiful Bill Act on July 4, 2025, to accommodate the President's self-imposed timetable. Optics!] Despite the flurry of IRS Regulations issued on Trump Accounts over the past year, it has yet to confirm that a gift to a Trump Account will qualify for the federal gift tax annual exclusion.

LLC Units: A gift of an LLC unit, or a limited partnership interest, may also not qualify for the annual exclusion gift because the subject of the gift does not confer immediately possession or enjoyment, or the income from the gifted interest.

Example: In *Hackl v. Commissioner*, 335 F.3d 664 (7th Cir 2003), a father transferred vacant land to an LLC. The father then then gave some of his LLC units to his children. The land held in the LLC did not generate any income. The LLC's operating agreement did not give a minority LLC member the right to compel the liquidation or redemption of his/her membership interest. Moreover, the LLC members could not remove their father as the manager of the LLC. With all these limitations, all the child-donee held 'was paper'- no right to income, no right to liquidate, no right to force the purchase or redemption of their gifted LLC interest. Due to these limitations, the Court held that the father's transfer of LLC units to his children were not *present interests* and thus the father was not allowed to claim that his gifts were protected by the annual exclusion. [When I was practicing law, after the *Hackl* decision, I started giving the donee of LLC units a 'put right' that compelled the LLC to buy-back their gifted LLC units, in order to create a *present interest* in the gifted LLC units.]

Irrevocable Trusts: The *crummey withdrawal right* strategy was devised to deal with the *present interest* requirement in order to assure that the annual gift exclusion applied to transfers to irrevocable trusts. By giving the trust beneficiary of an irrevocable trust, the right to withdraw the gift, or the portion of the gift equal to the applicable annual exclusion amount, the beneficiary would possess the right to receive and enjoy the transferred property. That limited right, usually open for 30 to 60 days, was sufficient for the *Crummey* Court to conclude that the trust beneficiary's withdrawal right (whether exercised or not) was a *present interest*. However, lots of questions exist regarding the exercise of a *crummey withdrawal right*, including the type and frequency of the trustee's notice of the transfer that is given by the trustee to the beneficiary, how and when the notice is given, and when the terms of the trust might otherwise frustrate the beneficiary's right of withdrawal or make it *illusory*.

Example: In Chief Counsel Advice (CCA) 201208026 two individuals funded an irrevocable trust. Each trust beneficiary was given a *crummey withdrawal right* based on the gift tax annual exclusion amount that was triggered each time an addition was made to the trust. The trust instrument gave the trustee the power to void the withdrawal rights for additions made to the trust. In addition, the trust instrument required that all disputes concerning the trust had to be submitted to resolution in an 'Other Forum', presumably some type of alternate dispute resolution (ADR) mechanism. The trust instrument further provided that if any trust beneficiary sought to avoid that ADR requirement and who moved to enforce the trust by means of initiating a state court proceeding, he/she would thereafter be excluded

as a trust beneficiary. The Chief Counsel was asked whether the trust's withdrawal rights gave rise to the annual exclusion as and when property was transferred to the trust. The Counsel noted that for the withdrawal right to qualify transfers to the trust for the annual exclusion, they had to be legally enforceable. The Counsel concluded that the withdrawal rights were *not* legally enforceable because the trust instrument explicitly foreclosed the beneficiary from enforcing their rights in a state court proceeding; as a matter of public policy, federal courts are not bound by the determinations of a 'private', aka ADR, forum. The Counsel also noted that as a practical matter, no beneficiary with the power to withdraw could enforce his/her withdrawal right in a state court proceeding because initiating that proceeding would result in the beneficiary facing 'dire consequences' of a forfeiture of his/her beneficial interest. The Counsel concluded that any transfers to the trust would *not* qualify for the federal gift tax annual exclusion because the trustee *could* declare the beneficiaries' withdrawal rights void and, in any event, those rights were *illusory*.

GST Tax & Crummey Withdrawal Rights: The annual exclusion rules are even trickier when it comes to the GST. A gift in trust can qualify for the GST annual exclusion if, but only if: (i) the gift meets the requirement for the gift tax annual exclusion under IRC 2503(b); *and* (ii) the trust property must vest in the beneficiary, which means that (a) no portion of the income or principal may be distributed to or for the benefit of any person other than the beneficiary, *and* (b) if the trust does not terminate before the beneficiary dies, the value of the trust assets must be included in the beneficiary's gross estate. [IRC 2642(c)(2).] As a result of these limitations, the annual exclusion for GST purposes will not be available even though the annual exclusion for gift tax purposes under IRC 2503(b) will be available. This result is because most *crummey trusts* have multiple beneficiaries and the trust is usually designed so that the value of none of the trust assets will be included in any trust beneficiary's gross estate. Accordingly, for a multi-beneficiary irrevocable trust to which gifts are made by the settlor, the settlor's GST exemption will have to be allocated, not only to the gifts with respect to a *skip person*, e.g., a grandchild, but also any gifts with respect to a *non-skip person*, e.g., the settlor's child, to avoid any possibility of future taxable distributions from [IRC 2613(b) or taxable terminations of the trust [IRC 2612(b).]

Conclusion: It is easy to remember the federal gift tax annual exclusion amount of \$19,000 per donee. Sometimes, though, we tend to forget that the *present interest* requirement can frustrate what otherwise looks like a transfer that will qualify for the federal gift tax annual exclusion, especially when 'hidden' restrictions or limitations accompany the asset that is

the subject of the gift. Then there are the additional statutory limitations to navigate when it comes to making a gift that is intended to satisfy the GST tax annual exclusion rules, making it at times difficult to qualify for the GST exclusion. The annual exclusion rules, in short, are deceptively simple, and easier than one might think to screw up.

If you would like to read additional missives, [click here](#).