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COMPLIANCE INSIGHT BRIEF

The Critical Importance of Crummey Powers and Notice Compliance in Trust Gift Planning

How Withdrawal Rights Transform Trust Contributions into Annual Exclusion Gifts and Why Documentation Matters

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Executive Summary

Contributions to irrevocable trusts generally do not qualify for the gift tax annual exclusion because beneficiaries receive only a future interest in the transferred assets. Crummey powers address this issue by granting beneficiaries a temporary right to withdraw contributed funds, thereby creating the present interest required for annual exclusion treatment. However, the effectiveness of a Crummey power depends on proper administration, particularly the timely delivery of written withdrawal notices to beneficiaries. Maintaining evidence of these notices helps substantiate the annual exclusion, withstand IRS scrutiny during audits, and preserve both gift tax and generation-skipping transfer (GST) tax planning benefits.

Key Takeaway: A Crummey power is only as effective as its administration, making timely written withdrawal notices essential to preserving annual exclusion treatment and avoiding unintended use of lifetime transfer tax exemptions.

The Critical Role of *Crummey* Powers in Trust Transfers

When a donor contributes assets to an irrevocable trust, the transfer traditionally fails to qualify for the gift tax annual exclusion under **Internal Revenue Code** § 2503(b). Because trust beneficiaries typically receive distributions only at a future date or at the trustee's discretion, the contribution is classified as a gift of a **future interest**.

To convert a future interest into a present interest—thereby securing the annual gift tax exclusion—trusts rely on ***Crummey* powers** (originating from the landmark 1968 Ninth Circuit case, *Crummey v. Commissioner*).

Mechanics of the *Crummey* Power

A *Crummey* power grants trust beneficiaries a limited, immediate right to withdraw a portion of the newly contributed trust property for a short window (typically 30 to 60 days).

- **The Present Interest Conversion:** The *legal right* to withdraw the funds—regardless of whether the beneficiary actually exercises that right—gives the beneficiary an immediate economic interest in the property.

- **Lapse of Power:** If the beneficiary does not exercise the withdrawal right within the designated period, the power lapses, and the assets remain in the trust corpus to be managed under the trust terms.



Why Timely Written Notices Are Essential
The IRS scrutinizes *Crummey* trust structures to ensure that withdrawal rights are substantive and not merely a paper sham. For a withdrawal power to be valid in the eyes of the IRS and the courts, **beneficiaries must have actual knowledge of their right to withdraw**.

Sending timely, written *Crummey* notices achieves three mandatory compliance goals:

1. **Proof of Present Interest:** A written notice demonstrates that the beneficiary was informed of their immediate right to demand funds. Without written proof of timely notice, the IRS can argue the withdrawal right was illusory, retroactively reclassifying the transfer as a taxable gift of a future interest.

2. **Substantiation on Audit:** During an audit of Form 709 or Form 706, the IRS routinely requests copies of contemporaneous *Crummey* letters along with signed delivery receipts or acknowledgments.

3. **GST Tax Annual Exclusion Integrity:** For Generation-Skipping Transfer (GST) tax planning under IRC § 2642(c), maintaining the underlying gift tax present-interest status is a prerequisite before evaluating whether trust shares qualify for GST annual exclusions.

Practitioner Takeaway: A trustee's failure to issue timely *Crummey* notices creates a silent, retroactive compliance flaw. If the IRS disallows the annual exclusion due to lack of notice, the donor's lifetime estate and gift tax exemption is consumed instead—potentially exposing the estate to unintended tax liabilities decades down the road.

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