

WITHDRAWAL RIGHTS IN IRREVOCABLE TRUSTS

Crummey Withdrawal Rights

Summary

A gift that does not give the recipient a “present interest” in the donated property does not qualify for the annual exclusion for federal gift-tax purposes. For this reason, it is common to allow the beneficiaries of irrevocable trusts to withdraw a portion of a trust contribution equal to the amount of the donor’s gift-tax annual exclusion. It is also common to require the trustee to give notice to the beneficiary of the withdrawal right, but court rulings have declared that giving notice is not required. If a withdrawal right is included, the withdrawal right must not be contingent upon the giving of notice.

A. CRUMMEY CASE

A.1 The Original *Crummey* Case¹. The Ninth Circuit Court of Appeals did not require notice in the original *Crummey* case; it only required a present interest. If the trust is domiciled in the Ninth Circuit, you have that precedent in favor of the proposition that notice is not required.

A.2 Lack of Legal Authority. Although the IRS insists that beneficiaries should be given notice of a withdrawal right, there is no letter ruling, revenue ruling, or regulation that requires a written notice.

A.3 Awareness without Formal Notice. If the beneficiaries have been informed of their withdrawal right in any manner, the IRS' requirement of knowledge has been met. An affidavit from the beneficiaries (or, if minors, from their natural guardians) of their awareness of the withdrawal right can serve as evidence of their awareness.

B. TAX COURT RULINGS

B.1 *Turner v. Commissioner*². Tax Court ruled in *Turner* that no notice was required to qualify for the annual exclusion. It is sufficient that the beneficiaries have the right to withdraw the amount contributed. The Tax Court in *Turner* stated that the fact that some or all of the beneficiaries did not know they had a right to withdraw “does not affect their legal right to do so.”

B.2 *Holland v. Commissioner*³. In *Holland*, the Tax Court addressed the IRS’ concern that the beneficiaries did not receive any notice while the trust required notice to be given. The Tax Court declared, “The trustees' failure to comply with this trust provision, however, does not require a finding that the beneficiaries did not have present interests in the gifts.”

¹ *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

² TC Memo 2011-2019.

³ TC Memo 1997-302.

C. POTENTIAL ISSUES WITH WITHDRAWAL RIGHTS

C.1 Exclusion Used Elsewhere. The withdrawal right provisions of an irrevocable trust should be drafted so that there is no withdrawal right as to trust contributions to the extent that the donor has already used his or her exclusion with other gifts.

C.2 Lapse and Not Release. The beneficiaries must allow the withdrawal right lapse and must not "release" the power. The beneficiaries may sign a document acknowledging their awareness of the withdrawal right, but they should not sign a document declining to exercise it. A release by a beneficiary constitutes a gift by the beneficiary, whereas a lapse does not.

C.3 Withdrawal Cannot Be Contingent upon A Post-Gift Event. While requiring notice of the withdrawal right is not, of itself, a problem, the trust agreement cannot make the withdrawal right contingent upon the giving or the receipt of notice or upon the occurrence of any other event that might occur after the contribution to the trust; otherwise, the present interest requirement is not met at the moment of the gift. Some trusts require the donor to elect to have a withdrawal right apply, and in such cases, it is imperative that the election be made prior to the contribution.

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