A Crummey trust can preserve the annual gift tax exclusion

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Traditionally, taxpayers have looked for ways to make the most of the $14,000 annual gift tax exclusion, and using a Crummey trust is one way to do that. But with the federal gift and estate tax exemption currently at an inflation-adjusted $5.49 million and the possibility of an estate tax repeal, it may seem that the annual exclusion is less relevant than ever before. Or is it?

Gift and estate tax law uncertainty

Although an estate tax repeal is called for under the "Unified Framework for Fixing Our Broken Tax Code" released by President Trump and congressional Republicans on September 27, there's no guarantee that legislation including the repeal will be passed. Even if it is, the repeal could be temporary and the estate tax could return in the future. And notably absent from the framework is any mention of a gift tax repeal.

So affluent people whose estates exceed the exemption amount need to continue to seek strategies for minimizing gift and estate taxes. And even those with more modest estates may want to take advantage of the annual exclusion to shelter assets against potential future changes in their wealth and federal estate tax laws. That's why a Crummey trust may be worth a look.

Convert a future interest into a present interest

The annual exclusion is limited to gifts of a "present interest," defined by IRS regulations as "an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property."

But what about gifts to a trust designed to distribute assets to your children or other beneficiaries at a future date? Certain types of trusts satisfy the present interest requirement, but only if the trust distributes all of its income currently or, in the case of a trust set up for a minor, distributes all of the principal and income to the beneficiary at age 21.

A Crummey trust satisfies the present interest requirement by giving beneficiaries the right to withdraw trust contributions for a limited period of time (typically 30 days after the contribution is made). To ensure that these withdrawal rights are treated as present interests, they must be real rights with economic substance, rather than a mere paper formality.

In addition, there can be no agreement with the beneficiaries — express or implied — that they won't exercise their withdrawal rights.

If you want to make annual exclusion gifts to loved ones but retain some control over when they use the gifted assets, a Crummey trust may be right for you. But before you set one up, be sure you understand the gift, estate and income tax implications. We can help you determine if a Crummey trust is right for your estate plan.

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