Discussion Issue: Taming the Crummey Power Gift-Over Challenge
Post date: January 14, 2025

The Issue. Irrevocable trusts with multiple beneficiaries can have a gift-over problem. It happens especially with irrevocable life insurance trusts, where contributions are made to the trust to pay insurance premiums. These trusts give beneficiaries a *withdrawal power* (called a "Crummey" power, see *Crummey et al. v. Commissioner*, 397 F.2d 82 (9th Cir. 1968)) which is intended to have the legal effect of making part of the contribution a "present interest" gift – in this way the donor/settlor can then apply the federal annual exclusion amount to offset the gift tax liability for part of the contribution to the trust . . . and the settlor/donor does not have to use up that much of his/her lifetime federal unified gift and estate tax credit.

When A Gift-Over Happens. So, when does this "gift-over" from a beneficiary to all other trust beneficiaries happen? It could happen where (1) there is more than one beneficiary of a trust, (2) each beneficiary holds a "Crummey" power (to withdraw a part of a contribution that is made to the trust, (3) a beneficiary does not exercise his/her withdrawal power, and (4) the value of what the beneficiary has a right to withdraw is more than the "greater of" $5,000 or 5% of the value of the trust (see, IRC Section 2514(e)).

The Tax Results of a Gift-Over. A gift-over to other beneficiaries is not a "present interest" gift, since the other beneficiaries do not have a right to withdraw this gift-over amount. As a result, the beneficiary who makes this gift-over is legally

obligated to file a Form 709 federal gift tax return, regardless of the value of the gift-over amount. Yes, any gift tax liability will be offset by the beneficiary applying part of his/her lifetime federal unified gift and estate tax credit, but this will then reduce the credit amount available to the beneficiary to cover gift tax liability on other property transfers made by the beneficiary during life, or at death.

Avoiding the Gift-Over. There are at least three (3) ways to avoid making a "gift-over".

- One way is to just have a separate trust for each beneficiary.
- Another way is to limit a beneficiary's exercise of the Crummey the power to a "greater of" amount – that is, the "greater of" $5,000 and 5% of the value of the trust. And the beneficiary's withdrawal power will continue to attach to any part of what that beneficiary can withdraw which exceeds this "greater of" amount. The continuing attachment of the power is called a "hanging power".
- A third way is to give each trust beneficiary, in the trust agreement, a testamentary general power of appointment over any value of a beneficiary's share of the contribution to the trust which the beneficiary can withdraw, and which would be considered to be a "gift-over" under IRC Section 2514(e) upon the failure by the beneficiary to exercise the withdrawal power.

A Fourth Way? A trust administration complexity arises when one beneficiary of a multiple-beneficiary trust does, in fact, exercise the Crummey withdrawal power. If this happens, should that beneficiary continue to have an equal distributive share of the entire trust? And if not, how does the trustee administratively account for separate shares? These considerations, along with the fact that multiple beneficiaries have a shared interest in a trust, suggest that using a *series limited liability company* ("SLLC") instead of a multiple-beneficiary trust could avoid the gift-over issue – by giving each person (who would otherwise be the beneficiary of a trust) his and her own separate series of a SLLC. The SLLC also provides numerous flexibilities that are well-established as a matter of law, and which are not readily available to a trust. The SLLC arrangement might look something like this:

- There would be a host LLC, and this host LLC would have a separate series for each person who, if there were a trust, would otherwise be a trust beneficiary.

- Each series is owned by one such person, instead of that person being the beneficiary of a trust. This would be the legal equivalent of there being a separate trust for each of several beneficiaries.
- The host LLC manager would be the equivalent of the trustee of a trust.
- The series charter would provide that the owner of the series is the person who, if there were a trust, would otherwise be a trust beneficiary.
- The manager of the host LLC would also be the manager of the series.
- The host LLC operating agreement could provide that, after the death of the person funding the LLC (who is the equivalent of the settlor of a trust),
    - The host LLC would have co-managers, with each being separately responsible to manage one of the series, and
    - Each owner of a series would have authority to appoint, remove and replace the host LLC co-manager who is the manager of that series.
- The host LLC operating agreement would provide that all contributions to the host LLC are allocated equally to each series.
- The charter for each series would give the person who is its owner the right to withdraw up to the federal annual exclusion amount from any amount which is allocated to the series.
    - Since no series has any interest in the other LLC series, the legal effect of this arrangement would be the same as having a trust with only one beneficiary – *so there is no gift-over issue*.
- The charter for each series could have the distribution provisions that a trust has. If the charter provisions are as restrictive as are in an irrevocable trust, the value of the series should not be includable in the estate of the series owner.
- The provisions of the series charter for unit ownership transfer could be the same as could be set out in a trust agreement.
- The LLC has statutory protection against the creditors of series owners which are stronger than the protections that trust beneficiaries have under the Oklahoma spendthrift statute. Unlike LLC protections, the spendthrift statute has (1) exception creditors, and (2) limitations on the amount of distributable trust income that can be protected from creditors.
- Since perpetuities limitations do not apply to LLCs, any defect in the current Oklahoma perpetuities statutes, as recently revised, would be avoided.