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Back to the Future Interest: The Origin and Questionable Legal Basis of the Use of Crummey Withdrawal Powers to Obtain the Federal Gift Tax Annual Exclusion

Bradley E.S. Fogel

Although the future of the estate tax is uncertain, the federal gift tax and the federal gift tax annual exclusion survived recent Congressional action. In fact, recent changes to the Internal Revenue Code may increase the use of the annual exclusion in the short term.

The federal gift tax annual exclusion allows donors to give \$11,000 per year to an unlimited number of donees free of gift tax. The exclusion is unavailable for gifts of “future interests,” including most gifts in trust. In order to make a gift in trust that fully qualifies for the annual exclusion, donees are frequently given temporary powers – called “Crummey powers” – to withdraw the gift to the trust.

Crummey powers are based on unjustifiable analogies to the federal income tax. In fact, Crummey powers are inconsistent with the language of the Internal Revenue Code, the Treasury Department’s regulations and United States Supreme Court precedent concerning the annual exclusion. Moreover, Crummey powers defeat the legislative intent behind the annual exclusion.

The law has become muddled in this area due to missteps by the IRS. Despite the potential for abuse, the IRS has never contested the fundamental validity of Crummey powers. Instead, the IRS accepted the basic premise behind Crummey powers and litigated side issues. The IRS’s agreement on the basic premises, however, precluded its success on the side issues.

The Treasury Department or Congress may effect an abrogation of Crummey powers. In the current political climate, however, they are unlikely to do so. Unless they do, the IRS will likely be forced to continue to accept the sham it sanctioned when it acquiesced in *Crummey v. Commissioner*.

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I. INTRODUCTION

Regardless of the future of the federal estate tax,² it seems that the gift tax will remain a feature of federal tax law.³ Moreover, recent changes to the federal estate and gift taxes have left unchanged⁴ what has been described as the most litigated aspect of the federal gift tax:⁵ the annual exclusion. One issue – the use of Crummey withdrawal powers to obtain the federal gift tax annual exclusion – was surrendered by the Internal Revenue Service (“IRS” or “Service”) over thirty years ago.⁶ However, Crummey powers are, in fact, not supported by the Internal Revenue Code (“Code”), Treasury Department regulations, United States Supreme Court precedent or the legislative intent behind the annual exclusion. As argued herein, Crummey powers have no place in the federal gift tax.

2. The Economic Growth Tax Relief Refunding Act of 2001 (“EGTRRA”) repealed the federal estate tax for decedents dying after Dec. 31, 2009. IRC § 2210(a). EGTRRA itself is, however, repealed after Dec. 31, 2010. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901 115 Stat. 38, (2001). Thus, the estate tax is repealed only for decedents dying during calendar year 2010.

The one-year repeal of the federal estate tax has earned EGTRRA the appellation “The Throw Momma From the Train Act” based on the assumption that heirs might wish to hasten the departure of a loved one in order to avoid the federal estate tax. Paul Krugman, *Reckonings; Bad Heir Day*, N.Y. Times, May 30, 2001, at A23. Many commentators feel that Congress will likely act sometime before 2010 to prevent the one-year repeal of the federal estate tax. See, e.g., Charles P. Rettig, *The Life & Death of Estate Taxes*, 24 Nov. L.A. Law. 32, 38 (Nov. 2001); David J. Wilfert & Martha J. Leighton, *Matching the Estate Planning Tool to the Investment Plan*, 314 PLI/EST 529, 535 (2002). Although making estate tax repeal permanent has been proposed, that proposal is, at the moment, dead. See, e.g., H.R. 2143, 107th Cong. (2001); see also Warren Rojas, *Permanent Estate Tax Repeal Dealt Blow in Senate*, 2002 Tax Notes 114-1 (June 13, 2002).

3. EGTRRA did not repeal the federal gift tax. CCH, 2001 Tax Legislation: Law, Explanation and Analysis Economic Growth and Tax Relief Reconciliation Act of 2001, ¶ 305 (2001); see also *infra* note 31.

4. See *infra* notes 134-51 and accompanying text. Cf. IRC § 2511(c).

5. Jeffrey G. Sherman, *‘Tis a Gift to be Simple: The Need for a New Definition of Future Interest for Gift Tax Purposes*, 55 U. Cin. L. Rev. 585, 585 (1987) (“The most troublesome and most frequently litigated issue in gift tax law is undoubtedly the availability of the ‘annual exclusion’ authorized by section 2503(b).”).

6. *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968); Rev. Rul. 73-405, 1973-2 C.B. 321.

The annual exclusion was enacted to exclude routine gifts (such as holiday and birthday gifts) from gift taxation.⁷ It exempts gifts under \$11,000 per year from a donor to each donee.⁸ The relatively modest dollar amount of the annual exclusion belies its importance.⁹ The exclusion is per year, per donor and, most notably, per donee.¹⁰ Thus, a munificent donor could, for example, give \$11,000 to every resident of the City of New York without incurring any gift tax liability. In a more mundane case, the matriarch of a family could give \$11,000 annually to each of her thirty-five descendants.¹¹ Thus, she could give away almost \$400,000¹² annually free of federal transfer tax.¹³

The annual exclusion is available only for gifts of “present interests.”¹⁴ This requirement makes the annual exclusion unavailable for most gifts in

7. H.R. Rep. No. 72-708 (1932); S. Rep. No. 72-665 (1932).

8. IRC 2503(b). The annual exclusion increased to \$11,000 per year, from \$10,000 per year, as of calendar year 2002. Compare Rev. Proc. 2001-59, 2001-52 I.R.B. 623.

9. Walter D. Schwidetzky, Estate Planning: Hyperlexis and the Annual Exclusion Rule, 32 Suffolk U. L. Rev. 211, 211 (describing the annual exclusion as “[o]ne of the true bonanzas in the Internal Revenue Code”).

In Stifel Stifles Kieckhefer, the author commented that taxpayers’ “preoccupation” with the federal gift tax annual exclusion was “excessive.” Dwight Rogers, 7 Tax L. Rev. 500 (1952). This somewhat unusual statement indicates either a failure to appreciate the power of multiplication or an argument that regardless of how many annual exclusions are obtained by the donor the amount is insignificant.

10. IRC § 2503(b).

11. This example is loosely based on the facts of Tech. Adv. Mem. 91-41-008 (Oct. 11, 1991). In that ruling, the donor made annual exclusion gifts, in trust, to each of her three children and thirty two grandchildren through the use of Crummey withdrawal powers. The IRS denied the exclusions for the grandchildren since they had only contingent remainder interests in the trust. *Id.* The IRS’s reason for denying the annual exclusions is not supported by law and has been rebuffed by the courts. See *infra* note 21. Regardless, the grandmother could clearly have obtained all thirty five annual exclusions had she merely made the gifts outright, rather than in trust. Regs. § 25.2503-3(b).

12. Thirty-five descendants x \$11,000 exclusion equals a \$385,000 transfer.

13. For calendar year 2002, the maximum federal estate and gift tax rate is 50%. IRC § 2001(c)(1). Thus, a \$385,000 tax-free transfer potentially saves up to \$192,500 in federal estate and gift tax.

The federal transfer tax system consists of three distinct, but interrelated, federal taxes -- the gift tax, the estate tax and the generation-skipping transfer tax. IRC §§ 2001, 2501, 2601. Although the estate and gift taxes were largely integrated in 1976, the integration was incomplete and they remain conceptually distinct. Richard B. Stephens, et. al, Federal Estate & Gift Taxation, § 1.02[1] (7th ed. 1996).

14. Regs. § 25.2503-3(b); IRC § 2503(b).

trust.¹⁵ Donors, however, frequently wish to make gifts in trust for a variety of tax and non-tax reasons. Crummey powers, named after a seminal Ninth Circuit case, have evolved in order to allow donors to side-step the present interest requirement and make gifts in trust that fully qualify for the federal gift tax annual exclusion.¹⁶ A Crummey power is a temporary power, which is generally given to the beneficiaries of the trust, to withdraw an aliquot portion of a gift made to the trust.

Although the IRS acquiesced in *Crummey v. Commissioner*,¹⁷ it has repeatedly tried to limit the use of Crummey powers. The IRS has had little success in this regard.¹⁸

The Service's zeal to limit the use of Crummey powers is easily understood. It cannot be seriously argued that Crummey powers are anything other than a ruse.¹⁹ Moreover, from their humble beginning in *Crummey v. Commissioner*, Crummey powers have evolved into a cornucopia of transfer tax

15. Regs. § 25.2503-3. Cf. IRC § 2503(c).

If trust income is paid to the beneficiary, then the income interest is a present interest and may be offset by the annual exclusion. Regs. § 25.2503-3(b); *Commissioner v. Lowden*, 131 F.2d 127, 128 (7th Cir. 1942). The remainder of the gift (the value in excess of the income interest) will be a future interest and no exclusion will be allowed to offset that portion. Regs. § 25.2503-3(a); *Fisher v. Commissioner*, 132 F.2d 383, 386 (9th Cir. 1942); *Sensenbrenner v. Commissioner*, 134 F.2d 883, 885 (7th Cir. 1943).

16. *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968). As discussed below, Crummey addressed withdrawal powers held by minors. *Id.* at 83. The Service never contested the use of withdrawal powers held by adults. See *infra* notes 61-74 and accompanying text. Despite this distinction, the term "Crummey power" is generally used to refer to powers held by adults or minors.

17. *Crummey*, 397 F.2d 82, action on Dec., 1966-144, 1972 WL 32868 (Jan. 14, 1972); Rev. Rul. 73-405, 1973-2 C.B. 321.

18. See, e.g., *Estate of Kohlsaat v. Commissioner*, 73 T.C. Memo (CCH) 2732 (1997); *Holland v. Commissioner*, 73 T.C. Memo (CCH) 3236 (1997); *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991).

19. John L. Peschel, Major Recent Tax Developments in Estate Planning, 33 U. S. Cal. Tax Inst. ch. 14, ¶ 1401 (1981) ("[T]he Crummey power, in theory, has a strong legal basis but, in practice, emits an equally strong odor of sham."); Willard H. Pedrick, Crummey is Really Crummy, 20 Ariz. St. L.J. 943, 948 ("[T]he [Crummey] withdrawal right is transparently a flim flam."); Benjamin N. Henszey, Crummey Power Revisited, *Taxes*, Feb. 1981, at 76, 77 ("[T]he IRS is aware that the [Crummey] power is a sham in most cases"); Dept. of the Treasury, General Explanations of the Administration's Revenue Proposals, 98 Tax Notes 22-6, ¶¶ 461-63 (Feb. 3, 1998) ("the Crummey power is essentially a legal fiction"); Joseph M. Dodge, A Deemed Realization Approach is Superior to Carryover Basis (and Avoids Most of the Problems of the Estate and Gift Tax), 54 Tax L. Rev. 421, 490 n.324 (2001).

Although Crummey withdrawal powers give the power-holder insubstantial rights, the argument that they should be disregarded under the sham transaction doctrine rests on tenuous footing. See *infra* notes 156-80 and accompanying text.

avoidance. Life insurance trusts,²⁰ naked Crummey powers²¹ and cascading Crummey powers,²² among others, are all based on the point of law yielded by the IRS when it acquiesced in *Crummey*.

20. Life insurance trusts are a powerful and ubiquitous estate planning technique. Bruce Felton, *Life Insurance Trusts Can Help Your Heirs*, N.Y. Times, Apr. 7, 1996, § 3, at 7. The life insurance is owned by the trustee of the trust. The trust assures that the insured has no “incidents of ownership” in the policy and that the policy proceeds will not be paid to the insured’s estate. Thus, the policy proceeds will not be included in the insured’s gross estate for federal estate tax purposes. IRC § 2042; Bradley E.S. Fogel, *Life Insurance and Life Insurance Trusts: Basics and Beyond*, *Probate & Property*, Jan./Feb. 2002, at 8, 8.

Typically, the premiums on life insurance held by the trust are paid by periodic gifts by the insured to the trust. Fogel, *supra*, at 10; Georgiana J. Slade, *Personal Life Insurance Trusts*, 807 *Tax Mgmt.*, (BNA) at A-6 – A-7. Based on Crummey withdrawal powers held by the beneficiaries, gifts to the trust are considered gifts of present interests that may be offset by the federal gift tax annual exclusion. Priv. Ltr. Rul. 81-180-51 (Feb. 9, 1981); Priv. Ltr. Rul. 78-260-50 (Mar. 29, 1978); Fogel, *supra*, at 10-11. If the annual exclusion was not available, the gifts made to the trust in order to pay the life insurance premiums would be taxable. Regs. § 25.2503-3; Slade, *supra*, at A-7.

21. Traditionally, Crummey withdrawal powers were given only to beneficiaries with relatively substantial interests in the trust. Taxpayers have, however, realized that the number of exclusions allowed can be multiplied, almost without limit, by giving individuals with little or no interest in the trust withdrawal powers. Kent Mason, *An Analysis of Crummey and the Annual Exclusion*, 65 *Marq. L. Rev.* 573, 593 (1982). Thus, the donor may obtain as many exclusions as she can find people who can be trusted not to exercise the withdrawal power. *Id.* at 593-94. Withdrawal powers held by individuals with little or no interest in the trust are frequently called “naked Crummey powers.” Malcolm A. Moore, *Crummey Trusts*, 26 *Philip E. Heckerling Inst. On Est. Plan.* ¶ 203.1 (1992).

The IRS has challenged naked Crummey powers in the courts. See, e.g., *Estate of Cristofani*, 97 T.C. 74; *Kohlsaatt*, 73 T.C. Memo 2732. Since the power-holder’s withdrawal power, rather than any other interest in the trust that the power-holder may have, is the source of the annual exclusion, the IRS’s arguments opposing the use of naked Crummey powers are largely specious. See, generally, Bradley E.S. Fogel, *The Emperor Does Not Need Clothes – The Expanding Use of “Naked” Crummey Withdrawal Powers to Obtain Federal Gift Tax Annual Exclusions*, 73 *Tul. L. Rev.* 555 (1998). Accordingly, the IRS has been unsuccessful in litigating this issue.

22. Carlyn S. McCaffrey, *Drafting and Planning to Minimize the Generation-Skipping Transfer Tax*, SE09 ALI-ABA 129, 174 (1999); Jonathan G. Blattmacher & Georgiana J. Slade, *Life Insurance Trusts: How to Avoid Estate and GST Taxes*, *Estate Planning*, 259, 263-64 (1995); see also *infra* text accompanying note 127.

Despite significant tax avoidance, the fundamental issue underlying Crummey powers has never been contested by the IRS.²³ Specifically, the IRS has never contested that a lapsing withdrawal power is a present interest for purposes of the annual exclusion. Indeed, the issue in Crummey related solely to withdrawal powers held by minor beneficiaries.²⁴ The IRS agreed with the taxpayer that exclusions based on withdrawal powers held by adults were justified.²⁵ Further, although the withdrawal powers in Crummey lapsed,²⁶ and the earlier cases all involved non-lapsing powers,²⁷ the IRS never argued that this distinction made a difference. Lapsing Crummey powers are, however, significantly more abusive than non-lapsing Crummey powers. Indeed, in 1987 the Joint Committee on Taxation (“Joint Committee”) sought to limit the tax avoidance inherent in Crummey powers by requiring that a gift subject to a Crummey power would be a present interest only if the power never lapsed.²⁸ The Joint Committee’s proposal met with no success in Congress.

The IRS lost the Crummey battle before it began. Hindsight makes abundantly clear that the real abuse in Crummey powers has nothing to do with the majority of the power-holder. The abuse is endemic to all Crummey powers. As discussed herein, in Crummey and the earlier cases, the IRS should have argued that a withdrawal power does not create a present interest, regardless of the majority of the power-holder.

23. See *infra* notes 156-80 and accompanying text.

Depending on the type of proceeding and the court, the IRS may be represented either by attorneys in the Service’s Office of the Associate Chief Counsel (Litigation) or the Justice Department. Michael I. Saltzman, *IRS Practice and Procedure* ¶ 1.02[3][e] at 1-14. Similarly, the litigant may be either the United States or the Commissioner of Internal Revenue. No distinction is made herein between the IRS and the attorneys representing the IRS, regardless of whether the attorneys actually work for the Service.

24. See, generally, Brief for Respondent Commissioner, *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968) (No. 21607).

25. *Crummey v. Commissioner*, 25 T.C. Memo (CCH) 772 T.C. Memo (RIA) 66144 (1966), *rev’d in part*, *Crummey*, 397 F.2d 82 (9th Cir. 1968).

26. *Crummey*, 397 F.2d at 83.

27. See, e.g., *Kieckhefer v. Commissioner*, 189 F.2d 118, 119-20 (7th Cir. 1951); *Gilmore v. Commissioner*, 213 F.2d 520, 522 (6th Cir. 1954); *Stifel v. Commissioner*, 197 F.2d 107, 110 (2nd Cir. 1952); *Perkins v. Commissioner*, 27 T.C. 601, 603-04 (1956); see also Jonathan E. Gopman, *Crummey, The Saga Continues*, 25 *Tax Mgmt. Estates, Gifts & Trusts Journal*, 194 (BNA) 200 (July/Aug. 2000) (“*Crummey* involved an *innovative* planning technique because it was the first case where a beneficiary’s demand power was limited to a specific period. Unlike the previous cases, the demand power was noncumulative, i.e., it lapsed on an annual basis.”).

28. Joint Committee on Taxation, *Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means*, 17-87, at 269 (Comm. Print 1987); see also *infra* note 98.

Part Two of this article addresses the basic workings of the annual exclusion.

Part Three discusses the operation of Crummey powers and notes that the Economic Growth Tax Relief Reconciliation Act of 2001 (“EGTRRA”) made few changes to the basic operation of Crummey powers.²⁹ Indeed, EGTRRA may increase the use of Crummey powers in the short term.³⁰

Part Four argues that *Crummey* was wrongly decided. A withdrawal power does not create a present interest for purposes of the federal gift tax annual exclusion.

Part Five discusses the possibilities for reform. Clearly, the abrogation of *Crummey* could be accomplished by Congress. The power of the IRS and the Treasury Department to administratively overrule *Crummey* is also considered.

Part Six concludes that, due in large part to the IRS’s missteps, the law concerning the use of Crummey withdrawal powers has gone awry. Although the use of Crummey powers is unsupportable, the IRS’s acceptance of *Crummey* for the past thirty years may force the IRS to lie in the bed that it made for itself (and the fisc) when it acquiesced in *Crummey*.

29. Cf. IRC § 2511(c); see also *infra* notes 134-51 and accompanying text.

30. See *infra* notes 150-51 and accompanying text.

II. Background, Purposes & Operation of the Annual Exclusion

Since the enactment of the current federal gift tax in 1932,³¹ the structure of the annual exclusion has remained unchanged.³² Although the amount of the annual exclusion has varied, the exclusion has always been a specific sum per donee per year.³³

31. Revenue Act of 1932, ch. 209, §§ 501-532, 47 Stat. 169 245-59 (1932); Stephens, *supra*, note 13, at ¶ 1.03[1].

An earlier gift tax statute was enacted in 1924 and then repealed in 1926. Stephens, *supra* note 13, at ¶ 1.03[1]. The 1924 gift tax was repealed due to its complexity and ease of avoidance. Regis W. Campfield, et al., *Taxation of Estates, Gifts & Trusts*, ¶ 2001 (22d ed.).

The purpose of both the 1924 gift tax and the current gift tax was to act as a backstop to the federal estate tax. Sherman, *supra* note 5, at 589; Campfield, *supra*, at ¶ 2001; see also W. Leslie Peat & Stephanie J. Willbanks, *Federal Estate and Gift Taxation* § 1.01, at 2, (2d . 1995); Stephens, *supra* note 13, at ¶ 1.03[1] (“The gift tax is a junior partner of the estate tax.”); *Sanford v. Commissioner*, 308 U.S. 39, 44 (1939) (“An important, if not the main purpose, of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death.”).

Considering that the federal gift tax was enacted predominately as a back-stop to the federal estate tax, it is curious that EGTRRA repealed (albeit for one year) the federal estate tax but not the gift tax. IRC § 2210(a). Earlier proposals considered by Congress repealed both the estate tax and the gift tax. See, e.g., H.R. 8, 107th Cong. (2001); H.R. 130, 107th Cong., (2001). However, commentators noted that repeal of the gift tax would permit substantial income tax avoidance by facilitating gifts of income producing property to lower tax bracket individuals. See, e.g., Jonathan G. Blattmachr & Mitchell M. Gans, *Wealth Transfer Tax Repeal: Some Thoughts on Policy and Planning*, *Trusts & Estates*, Feb. 2001, at 49, 58; William M. VanDenburgh & Philip J. Harmelink, *The Uncertainty of Death and Taxes*, *Journal of Accountancy*, Oct. 2001, at 95, 97. Therefore, Congress retained the federal gift tax in order to use it as a backstop to the federal income tax. John S. Seich & Jason L. Seifert, *Estate Planning in a Time of Unpredictability*, *Ohio CPA Journal*, Jan. 1, 2002, at 30; Campfield, *supra*, at ¶ 1033. Further, retaining the federal gift tax reduced the estimate of the cost of EGTRRA by, at least theoretically, ameliorating the possible income tax loss.

32. Revenue Act of 1932, ch. 209, § 504, 47 Stat. 169, 247 (1932); Boris I. Bittker, *The \$10,000 Annual Per-Donor Gift Tax Exclusion*, 44 *Ohio St. L.J.* 447, 447 (1983).

The 1924 gift tax contained an annual \$50,000 per donor exclusion. Revenue Act of 1924, ch. 234, § 321, 43 Stat. 253, 314 (repealed 1926).

33. Economic Recovery Tax Act of 1981. Pub. L. No. 97-34, § 441(a), 95 Stat. 172, 319 (1981). The annual exclusion was \$5,000 between 1932 and 1938. Revenue Act of 1932 ch. 209, § 504, 47 Stat. 169, 247 (1932). Beginning in 1939, it was reduced to \$4,000. IRC § 1003(6)(2) (1939). It was reduced, once again, in 1942 to \$3,000. Revenue Act of 1942, ch. 619 § 454, 56 Stat. 798, 953 (1942); H.R. Rep. No. 77-2333,

The annual exclusion was intended as a rule of administrative convenience. It was meant to exempt gifts of “relatively small amounts” from taxation and the concomitant record-keeping requirements.³⁴ Indeed, in 1942 the House of Representatives noted that only “administrative difficulties” prevented complete elimination of the annual exclusion.³⁵

Despite the original purpose of the annual exclusion, it has grown into a significant estate planning tool.³⁶ Indeed, donors frequently make use of the

at 37 (1942) (noting that the \$4,000 annual exclusion allowed donors “to distribute property of large aggregate value over a period of years, free not only of gift tax but of estate tax as well”); H. R. Rep. No. 75-1860, at 61 (1938) (“In view of the frequency with which donors are induced by the exemption to build up estates of considerable size for the members of their families, the present amount of the exemption is regarded as unreasonably large.”). The annual exclusion remained \$3,000 until 1982. In 1982, the exclusion was increased to \$10,000 per year. Bittker, *supra* note 32, at 447; Pub. L. No. 97-34, § 441(a), 95 Stat. 172, 319 (1981).

The Taxpayer Relief Act of 1997 indexed the annual exclusion for inflation, beginning after calendar year 1998. IRC § 2503(b)(2); Pub. L. No. 105-34, § 501(c) 111 Stat. 845 (1997). For calendar year 2002, the exclusion is \$11,000 per year. Rev. Proc. 2001-59, 2001-52 I.R.B. 623.

Although the exclusion is, in nominal terms, larger than it has ever been, it has been more substantial. For example, the \$5,000 annual exclusion enacted in 1932 is equivalent to \$65,789 in 2002 dollars. <<<http://www.cjr.org/resources/inflater.asp>>>; Revenue Act of 1932, ch. 209 § 504, 47 Stat. 247 (1932).

34. H.R. Rep. No. 772-708, at 29 (1932) (“[The annual exclusion] on the one hand, is to obviate the necessity of keeping an account of and reporting numerous small gifts, and, on the other, to fix the amount sufficiently large to cover in most cases wedding and Christmas gifts and occasion gifts of relatively small amounts.”); see also S. Rep. No. 72-665, at 41 (1932).

Arguably, the annual exclusion far exceeds the “relatively small amounts” discussed by the House and Senate. See Pedrick, *supra* note 19, at 951.

35. H.R. Rep. No. 77-2333 (1942) (“Under existing law, the first \$4,000 in value of gifts to any person during the year is not counted in the total of net gifts subject to tax. . . While administrative difficulties prevent the abolition of the exclusion, your committee recommend [sic] that it be reduced to \$3,000.”). The exclusion was reduced to \$3,000 in 1942 Revenue Act of 1942 ch. 619, § 454, 56 Stat. 798 953 (1942).

36. Kent D. Schenkel, Will a Crummey Beneficial Interest Qualify for an Annual Gift Tax Exclusion 1997, *Tax Adviser*, 378; Scott H. Malin, Crummey Withdrawal Rights: Watch Your Step, *Probate & Property*, Mar./Apr. 1996, at 52.

full annual exclusion, often through the use of Crummey powers,³⁷ without considering the occasion gifts made by the donor to the donee.³⁸

The Code expressly provides that the annual exclusion is not available for gifts of “future interests.”³⁹ The Code does not, however, define the term. The Treasury Department regulations provide a definition:

“‘Future interest’ is a legal term, and includes reversions, remainders, and other interests or estates, whether a vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.”⁴⁰

The regulation is similar to the definition of “future interest” in the Congressional committee reports⁴¹ and has been approved by the United States Supreme Court.⁴² Based on this definition, the annual exclusion is available only if the donee receives immediate enjoyment of property.⁴³ Even a short

37. Crummey powers are not the only means for making annual exclusion gifts in trust. For example, gifts to a minor in a trust that meets the requirements of section 2503(c) of the Code may be fully offset by the annual exclusion. IRC § 2503(c). Such trusts are, however, substantially less flexible than trusts using Crummey powers.

38. Robert B. Smith, *Should We Give Away the Annual Exclusion?* 1 Fla. Tax. Rev. 361, 383 (1993); Boris J. Bittker, et. al., *Federal Estate and Gift Taxation* 161 (7th ed. 1996); David C. Johnson, *The 1997 Federal Estate, Gift and Trust Tax Changes*, 22 S. Ill. U. L.J. 27, 37 (1997); Peter C. Maxfield, *Troublesome Trust Powers Under Section 2503(b)*, 47 Taxes, at 457, 484 (1969).

The routine occasion gifts made by the donor are disregarded with impunity due to some combination of the difficulty the IRS would have in tracking small gifts and the average layperson’s understanding that such gifts are beyond the scope of the federal gift tax. Smith, *supra*, at 394-95; see also Johnson, *supra*, at 37 n.29.

39. IRC § 2503(b)(1).

“In the case of gifts (*other than gifts of future interests in property*) made to any person by the donor during the calendar year, the first \$10,000 of such gifts to such person shall not, for purposes of [the gift tax] be included in the total amount of gifts made during such year.” (emphasis added).

Id.

40. Regs. § 25.2503-3(a).

41. H. R. Rep. No. 72-708, (1932) (“The exemption does not apply with respect to a gift to any donee to whom is given a ‘future interest’. The term ‘future interests in property’ refers to any interest or estate, whether vested or contingent, limited to commence in possession or enjoyment at a future date.”).

42. *Commissioner v. Disston*, 325 U.S. 442, 446 (1945).

43. *Fondren v. Commissioner*, 324 U.S. 18, 20 (1945) (“Under these decisions it is not enough to bring the exclusion into force that the donee has vested rights. In addition he must have the right presently to use, possess or enjoy the property.”).

delay in a beneficiary's enjoyment is sufficient to render the gift a future interest.⁴⁴

Fondren v. Commissioner, decided by the United States Supreme Court in 1945, is illustrative of the metes and bounds of the future interest exception.⁴⁵ In *Fondren*, the Court addressed several trusts created by the taxpayer for the benefit of her minor grandchildren.⁴⁶ The trustee had the power to use trust principal or income for the beneficiary, if a necessity arose.⁴⁷ The Court noted that the beneficiaries' parents were sufficiently wealthy so that such a need seemed unlikely.⁴⁸

The Court held that a beneficiary has a future interest unless he has a "substantial present economic benefit" in the gift.⁴⁹ Since the trust at issue was a discretionary trust,⁵⁰ the Court held that the beneficiary's right was not "absolute and immediate;" thus, the exclusions were denied.⁵¹ A few months

44. *Id.* at 26; *Hessenbruch v. Commissioner*, 178 F.2d 785, 787 (3d Cir. 1950).

45. 324 U.S. 18 (1945).

46. *Id.*

With respect to gifts in trust, the United States Supreme Court decided early in the history of the annual exclusion that the crucial inquiry was whether the beneficiary(ies) of the trust, received a present interest in the gifted property. *Helvering v. Hutchings*, 312 U.S. 393, 396-67 (1941); *Ryerson v. United States*, 312 U.S. 405, 408 (1941). In contrast, earlier cases held that the key inquiry was whether the trustee received a present interest, regardless of the beneficiary's interest in the trust. *Commissioner v. Krebs*, 90 F.2d 880, 881 (3d Cir. 1937) (noting that the trustees received a present interest).

47. *Fondren*, 324 U.S. at 22-24.

"In view of the apparently conflicting terms of [the trust agreement] for use of the corpus, the scope of the trustee's discretion is by no means clear. . . whether the disposition is in [the trustee's] judgment entirely, as the first clause indicates, or under the second is only with reference to how much of the fund may be needed, the trustee cannot act in any case to apply corpus or income for the support, maintenance and education of the beneficiary until necessity arises."

Id.

48. *Id.* at 23. In fact, the trust agreement noted that distribution to the beneficiaries during minority were unlikely. *Id.*

49. *Id.* at 20. "It is not enough to bring the exclusion into force that the donee has vested rights. . . [t]hese terms are not words of art, like "fee" in the law of seizin, . . .").

50. In a "discretionary trust" the trustee may, but is not required to, make distribution of income or principal to the beneficiary. Restatement (Second) of Trusts § 155; Black's Law Dictionary 1515 (7th ed. 1999).

51. *Fondren*, 324 U.S. at 24.

after *Fondren*, the United States Supreme Court reaffirmed its holding that, as a general rule, no annual exclusion would be allowed for gifts to a discretionary trust.⁵²

The *Fondren* Court noted, in *dicta*, that if the beneficiary was entitled to periodic payment of trust income, then the gift of the income would be a present interest.⁵³ The gift of the corpus, however, would be a future interest. Thus, for example, a gift in trust that required trust income be regularly paid to the beneficiary would be partially a gift of a present interest, regardless of when (or if) trust principal was to be paid.⁵⁴ In contrast, a gift to a discretionary trust is entirely a future interest, even if trust principal was required to be paid to the beneficiary shortly after the gift.⁵⁵ In this regard, the future/present interest distinction is somewhat counter-intuitive.⁵⁶

Thus, a typical gift in trust is at least partially a future interest.⁵⁷ Donors, however, frequently prefer to make gifts in trust (as opposed to outright) for a variety of tax and non-tax reasons.⁵⁸ This is especially true if the beneficiary is a minor.⁵⁹ Therefore, donors sought a method of making gifts in

52. *Commissioner v. Disston*, 325 U.S. 442, 449 (1945); see also *Prejean v. Commissioner*, 345 F.2d 995, 996 (5th Cir. 1966). Cf. *Morgan v. Commissioner*, 42 T.C. 1080, 1089 (1964).

53. *Fondren*, 324 U.S. at 21 (“If the income of a trust is required to be distributed periodically, as annually, but the distribution of the corpus is deferred, the gift of the income is one of a present interest, that of the corpus is one in futuro.”); see also Regs. § 25.2503-3(b).

The term present interest, although not used in the Internal Revenue Code, is used extensively in the Treasury Department regulations. See, e.g., Regs. § 25.2503-3(b). A present interest is, rather obviously, an interest that is not a future interest. *Id.*

54. Regs. § 25.2503-3(b). Only the beneficiary’s income interest would be a present interest. Thus, only that portion is offset by the annual exclusion.

55. See, e.g., *Hessenbruch v. Commissioner*, 178 F.2d 785, 787(3d Cir. 1950); see also *United States v. Pelzer*, 312 U.S. 399, 403-04 (1941).

56. *Charles v. Hassett*, 43 F. Supp. 432, 434 (D. Mass. 1942) (noting that a “layman” would be surprised to learn what constitutes a future interest as compared to what constitutes a present interest for purposes of the annual exclusion).

57. Regs. § 25.2503-3.

58. For example, a well planned gift in trust can yield an income tax savings. See generally IRC §§ 551, 552, 661, 662. In addition, assets held in a spendthrift trust are not generally subject to claims by beneficiaries’ creditors. Erwin N. Griswold, *Spendthrift Trusts* § 1 (2d ed. 1947); *Restatement (Third) of Trusts* § 58 (Tentative Draft No. 2, 1999).

59. For example, by making the gift in trust, the donor can designate a trustee to manage the property for the benefit of the minor. Further, donors are frequently concerned that the gift would be squandered if the donee received unfettered access to it at a young age. Through a trust, the donor can delay a minor donee’s unfettered access to the gift. Congress was concerned that it was unclear how annual exclusion gifts could be made to minors. Thus, in 1954, it enacted section 2503(c) of the Internal Revenue

trust that fully qualified for the annual exclusion. One such method – the use of withdrawal powers to create a present interest – led to the Ninth Circuit’s decision in *Crummey v. Commissioner*⁶⁰ in 1968.

III. THE ORIGINS AND USE OF CRUMMEY POWERS

A. *Crummey v. Commissioner and its Precedents*

The first reported case to address the availability of the federal gift tax annual exclusion based on a withdrawal power⁶¹ was *Kieckhefer v. Commissioner*.⁶² It was decided by the Seventh Circuit in 1951. In *Kieckhefer*, the donor created a trust for the benefit of his minor grandchild.⁶³ The trust was a discretionary trust; that is, the trustee had discretion to use income or principal for the beneficiary “as may be necessary for [his] education, comfort and support. . .”⁶⁴ Thus, gifts to the trust would not, in and of themselves, qualify for the federal gift tax annual exclusion.⁶⁵ However, the trust agreement also gave the beneficiary, or his “legally appointed guardian,” the right to

Code to permit gifts to certain discretionary trusts for the benefit of minors to qualify for the federal gift tax annual exclusion. IRC § 2503(c) (1954); S. Rep. No. 83-1622, at 127, 83rd Cong., 2d Sess. at 4760 (1954); see also *Estate of Levine v. Commissioner*, 526 F.2d 717, 719 (2nd Cir. 1975). Such trusts are frequently called “2503(c) trusts.”

One of the requirements for a trust to qualify as a 2503(c) trust, is that trust assets must be distributed to the beneficiary upon her attaining age twenty-one. IRC § 2503(c)(3). Although there are some methods available to ameliorate the risk that the young beneficiary will squander the assets, the risk remains significant and, in many donors’ opinion, unacceptable. See, e.g., Rev. Rul. 74-43, 1974-1 C.B. 285. Thus, many donors are not satisfied with 2503(c) trusts as a means to make annual exclusion gifts to minors.

60. 397 F.2d 82 (9th Cir. 1968).

61. An earlier case, *Strekalovsky v. Delaney*, involved a trust containing a demand clause created for the benefit of a minor. 78 F. Supp. 556 (D. Mass. 1948). Although the court allowed the annual exclusions claimed by the taxpayer, it did not base its decision on the demand clause. *Id.* at 558. Instead, the court held that, since the trust agreement provided that the trustee had discretion to make distributions to the child “as if” the trustee were a guardian, the minor beneficiary received a present interest. *Id.* at 557; see also *United States v. Baker*, 236 F.2d 317, 320 (4th Cir. 1956); *Kieckhefer v. Commissioner*, 15 T.C. 111 (1950), rev’d, 189 F.2d 118 (1951) (noting that *Strekalovsky* was not on point due to the provisions of the trust).

62. 189 F.2d 118 (7th Cir. 1951).

63. *Id.* at 119.

64. *Id.*

65. *Id.*; see also *Fondren v. Commissioner*, 324 U.S. 19, 21; *Commissioner v. Disston*, 325 U.S. 442, 448-49 (1945).

terminate the trust and demand distribution of the trust assets.⁶⁶ The taxpayer claimed that this demand right made gifts to the trust present interests. Indeed, the sole purpose behind the demand power was to obtain the federal gift tax annual exclusion for gifts made to the trust.⁶⁷

The IRS's argument in *Kieckhefer* was quite straightforward. The Service reasoned that, as a minor, the beneficiary could not make an effective demand. Moreover, although the trust agreement expressly allowed a "legally appointed guardian" to make a demand on behalf of the beneficiary, no such guardian had been appointed. Therefore, the Service reasoned, the demand clause was meaningless. Absent the demand clause, the trust in *Kieckhefer* was a routine discretionary trust, gifts to which are future interests.⁶⁸

The court held that the gifts were present interests that qualified for the federal gift tax annual exclusion.⁶⁹ The court agreed with the IRS that the minor beneficiary could not exercise the demand power.⁷⁰ Unlike the IRS, however,

66. *Kieckhefer*, 189 F.2d at 120.

67. Brief for Respondent Commissioner at 10, *Kieckhefer*, (No. 10301). ("[I]t should be noted that [the demand] provision was inserted merely in an attempt to convert an obvious 'future interest' . . . into a seeming 'present interest.' If the money had been given directly to the donee-child, then a guardian would have been required, with the concomitant incidental expenses and nuisance requirements. The taxpayer wished to avoid this. Hence, the trust involved here was established.").

It is unclear why the IRS made this point in its brief. The Service may have been trying to argue that the donor did not intend to create a present interest and, thus no exclusion should be allowed. The donor's intent is, however, largely irrelevant. *Fondren*, 324 U.S. at 28. Moreover, the difficulty in making an annual exclusion gift to a minor, alluded to by the IRS, was a central reason that the Seventh Circuit decided to allow the claimed exclusions. Brief for Respondent Commissioner at 10, *Kieckhefer* (No. 10301); *Kieckhefer*, 189 F.2d at 121.

In 1954, Congress enacted section 2503(c), which facilitates making annual exclusion gifts to minors in trust. See *supra* notes 37, 59. The trust in *Keichkhefer* would have qualified as a "2503(c) trust," had that section been enacted at that time. *Kieckhefer*, 189 F.2d at 119; IRC § 2503(c).

68. Brief for Respondent Commissioner at 6, 10, *Kieckhefer*, (No. 10301); *Kieckhefer*, 189 F.2d at 119; *Fondren*, 324 U.S. at 21; *Disston*, 325 U.S. at 448-49; see also *Kieckhefer*, 15 T.C. 111, 114 (1950), *rev'd*, 189 F.2d 119 ("But for . . . [the demand clause] this case could be resolved for the [IRS] without further discussion under the authority of *Fondren v. Commissioner*.").

69. *Kieckhefer*, 189 F.2d at 121.

70. *Id.* at 120-21.

The Tax Court denied the exclusions sought by the taxpayer based on its conclusion that the minor beneficiary could not make an effective demand. *Kieckhefer*, 15 T.C. at 116, *rev'd*, 189 F.2d 118. The Tax Court noted that even if the minor's parents sought the appointment of a guardian for the purposes of exercising the demand power, it is unclear whether a court would appoint a guardian for that purpose. *Id.* In contrast, in its brief the taxpayer argued that the beneficiary could make an effective

the court did not find this fact dispositive. The Seventh Circuit reasoned that the Service's position was untenable because it made it nearly impossible to make an annual exclusion gift to a minor.⁷¹ Thus, the court concluded (without citation) that restrictions and contingencies caused by the disability of the beneficiary (in this case, minority) are disregarded in determining whether a gift is a present interest.⁷²

This conclusion brought the court to a new issue: whether a demand power held by an adult created a present interest. This issue was discussed at length by the taxpayer in its brief.⁷³ It was not, however, addressed by the IRS.⁷⁴ The taxpayer argued that, disregarding the issue of minority, the beneficiary's demand power was the "equivalent" of outright ownership.⁷⁵ The taxpayer

demand. Brief for Petitioner Taxpayer at 5, *Kieckhefer*, (No. 10301) "The Court may not rewrite the trust agreement by holding a minor beneficiary is incapable of making an effective demand for the trust estate, where the trust agreement expressly grants the beneficiary that right."

71. *Kieckhefer*, 189 F.2d at 121. "The Commissioner's reasoning reduces to a myth his concession that 'gifts to minor beneficiaries are placed on an equality with gifts to adults' . . . [N]o illustration is given as to how a gift of a 'present interest' could be made to minor of tender years."

72. *Id.* at 122

[T]he fallaciousness of the Commissioner's contention is the failure to distinguish between restrictions and contingencies imposed by the donor (in this case the trust instrument), and such restrictions and contingencies as are due to disabilities always incident to and associated with minors and other incompetents. As to the former, it is authoritatively settled that a gift upon which the donor imposes such conditions are restrictions is a future interest. In the latter, such restrictions as exist are imposed by law due to the fact that the beneficiary is incapable of acting on his own. In our view, and we so hold, such restrictions could not transform what otherwise would be a gift of present interest to one of future interest.

Id.

73. Brief for Petitioner Taxpayer at 4-6, 8-13, *Kieckhefer*, (No. 10301).

74. See generally Brief for Respondent Commissioner, *Kieckhefer*, (No. 10301). The IRS did attempt to distinguish the case relied on by the taxpayer for this point. *Id.* at 13 (citing *Strekalovsky v. Delaney*, 78 F.Supp 556 (D. Mass 1948)). See also Brief for Petitioner Taxpayer at 4, 6, *Kieckhefer*, 189 F.2d 118 (No. 10301). The Service's argument was, however, largely based on its main point that the demand power in *Kieckhefer* was an "empty sham" due to the minority of the beneficiary. Brief for Respondent Commissioner at 13, *Kieckhefer*, (No. 10301).

75. Brief for Petitioner Taxpayer at 4, *Kieckhefer*, (No. 10301).

relied on cases regarding the income taxation of trusts with demand provisions.⁷⁶

The Kieckhefer court did not mention the taxpayer's argument or cite the suggested cases. Instead, the court "suppos[ed]" that the gift would "unquestionably" be a present interest, if the beneficiary were an adult.⁷⁷ Thus, the court concluded that a withdrawal power held by an adult created a present interest. Further, as previously noted, the court also held that the legal disability of a minor would, for purposes of determining the availability of the annual exclusion, be ignored.⁷⁸ Thus, the Kieckhefer court allowed the annual exclusions claimed by the taxpayer.⁷⁹

Three years after Kieckhefer, the Sixth Circuit adopted the Kieckhefer court's holding in a similar case.⁸⁰ Moreover, in a case that did not directly involve withdrawal powers, the Fourth Circuit also adopted the reasoning of the

76. *Id.* at 4-5, 7-11. In these cases the courts concluded that the income earned by the trust would be taxed to the beneficiary that held the withdrawal power. See *infra* notes 211-12 and accompanying text.

77. Kieckhefer, 118 F.2d at 121 ("Suppose in the instant situation that the beneficiary had been an adult rather than a minor. Such adult, of course, could immediately have made a demand upon the trustee and have received the trust property. We suppose that such a gift unquestionably would be one of a 'present interest.'"); see also *Stifel v. Commissioner*, 197 F.2d 107, 110 (2d Cir. 1952).

As discussed *infra*, the Kieckhefer court's statement regarding a withdrawal power held by an adult is incorrect. See *infra* notes 181-210 and accompanying text. Further, the court's juxtaposition of the terms "suppose" and "unquestionably" seems to be an oxymoron. See, Webster's Third New International Dictionary 2298, 2507 (3d ed. 1971), compare definition of "suppose" as "to accept tentatively as true or real" or "to assume as true for the sake of argument," with definition of "unquestionable" as "acknowledged as beyond question or doubt" or "indisputable."

78. See *supra* note 72 and accompanying text.

79. Kieckhefer, 189 F.2d at 122.

80. *Gilmore v. Commissioner*, 213 F.2d 520, 522 (6th Cir. 1954). In *Gilmore*, the taxpayer created seven trusts – one for the benefit of each of his minor grandchildren. *Id.* at 520. The trust agreements were largely identical. *Id.* Each trust contained a provision that gave the beneficiary the power to terminate the trust and demand distribution of the trust assets. *Id.* The Sixth Circuit largely adopted the reasoning of Kieckhefer and allowed the claimed annual exclusions. *Id.* at 522-23 (citing, Kieckhefer, 189 F.2d 118).

Although the Tax Court in *Gilmore* denied the annual exclusions claimed by the taxpayer, its decision was partially based on its conclusion that the agreement did not give the beneficiaries withdrawal powers. *Gilmore v. Commissioner*, 20 T.C. 579, 583-84 (1953), *rev'd*, 213 F.2d 520. The Sixth Circuit disagreed and held that the trust agreement gave the beneficiaries enforceable withdrawal powers. 213 F.2d at 523.

Seventh Circuit in *Kieckhefer*.⁸¹ In contrast, in *Stifel v. Commissioner*⁸² the Second Circuit rejected *Kieckhefer*.⁸³ The facts of *Stifel* are quite similar to the facts of *Kieckhefer*.⁸⁴ In *Stifel*, however, the court held that it was necessary to consider the surrounding circumstances in determining whether the gift was a present interest.⁸⁵ The court noted that the minors could not by themselves make an effective demand and that no guardian had been appointed.⁸⁶ Thus, the *Stifel* court concluded that gifts to the trust were future interests and the annual exclusions were denied.⁸⁷ In *dicta*, however, the court noted that the claimed exclusions would have been allowed if the beneficiaries were adults.⁸⁸

Against this backdrop, the Ninth Circuit decided *Crummey*.⁸⁹ The taxpayer in *Crummey* created four different trusts – one for the benefit of each of her children. Each trust contained a demand provision that allowed the beneficiary, or the beneficiary’s guardian, to withdraw any gift made to the trust.⁹⁰ Two of the four beneficiaries were adults and two were minors.⁹¹ The

81. *Baker v. Commissioner*, 236 F.2d 317 (4th Cir. 1956). The taxpayer in *Baker* created a trust in which the trustee was directed to use trust assets for the benefit of the minor beneficiary “as if” the trustee were the beneficiary’s guardian. *Id.* at 319. The *Baker* court allowed the annual exclusions since the beneficiary received rights that were essentially equivalent to the rights the beneficiary would receive if the gift was actually made to a guardian. *Id.* at 320. The *Baker* court specifically endorsed *Kieckhefer*. *Id.* at 320 (citing, *Kieckhefer*, 189 F.2d 118).

82. 197 F.2d 107 (2d Cir. 1952).

83. *Id.* at 110 (citing, *Kieckhefer*, 189 F.2d 118) (noting that *Kieckhefer* “under-estimates the traditional judicial knack of line drawing.”).

84. Both *Stifel* and *Kieckhefer* involved gifts to a trust that contained a provision granting the minor beneficiary’s guardian the power to terminate the trust and demand the trust assets. The trust in *Kieckhefer* provided that the demand power could be exercised by the beneficiary or “the legally appointed guardian for his estate.” 118 F.2d at 120. In *Stifel*, the demand power could be exercised by the beneficiary’s general guardian, if any, or by any special guardian appointed for such purpose by a court. 197 F.2d at 109.

85. *Stifel*, 197 F.2d at 110 (noting that if the court “irrevocably lock[ed] itself inside the ‘four corners’ of the [trust agreement] a donor could make gifts which on paper were 100% present but in practice were 100% future.”).

86. *Id.* at 110.

87. *Id.*

88. *Id.*

89. 397 F.2d 82 (9th Cir. 1968).

90. *Id.* at 83.

91. *Id.* at 82. The gifts were made in 1962 and 1963. *Crummey*, 397 F.2d at 82-83. One of the beneficiaries, Janet Sheldon *Crummey*, attained age twenty-one during 1963. *Crummey*, 25 T.C. Memo (CCH) 772, T.C. Memo (RIA) 66144 (1966), rev’d, *Crummey*, 397 F.2d 82. The IRS originally denied the annual exclusions claimed based on Janet Sheldon *Crummey*’s withdrawal powers. *Id.* In the Tax Court, however, the Service conceded that the taxpayers were entitled to an exclusion based on Janet

Service allowed the exclusions derived from the withdrawal powers held by the adult beneficiaries.⁹² The IRS and the Tax Court denied the annual exclusions allocable to the withdrawal powers held by the minor beneficiaries.⁹³

Although not noted by the Crummey court or the IRS in its brief, Crummey involved an innovative estate planning technique that was not presented in the earlier cases.⁹⁴ Specifically, the withdrawal powers in Crummey lapsed.⁹⁵ It seems that the power-holder's interest is closest to outright ownership, and thus more likely a present interest,⁹⁶ if the withdrawal power does not lapse. Moreover, a non-lapsing withdrawal power is a more "absolute" right than a lapsing power; thus, the argument that it is a present interest is stronger.⁹⁷ From an estate planning point of view, however, a lapsing withdrawal power is significantly more useful than a non-lapsing power.⁹⁸

Sheldon Crummey's withdrawal power for 1963 since she attained age twenty-one during that year. *Id.*; see also Brief for Respondent Commissioner at 26-29, Crummey (No. 21607). With respect to 1962, the IRS attempted to deny the exclusion since Janet Sheldon Crummey, although over age eighteen, was still a minor under age twenty-one. Brief for Respondent Commissioner at 26-29, Crummey (No. 21607).

92. Crummey, 25 T.C. Memo (CCH) at 772, T.C. Memo (RIA) rev'd, Crummey, 397 F.2d 82 ("No question is raised as to the right of the adult beneficiary, John Knowles Crummey, to make an effective demand . . . His right was secure and he therefore received a 'present interest.'").

93. Crummey, 25 T.C. Memo (CCH) at 772, T.C. Memo (RIA) at rev'd, 397 F.2d 82.

94. Brief for Respondent Commissioner, Crummey (No. 21607); Gopman, *supra* note 27, at 200.

95. The withdrawal powers in Crummey lapsed at the end of the calendar year in which the gift to the trust was made. Crummey, 397 F.2d at 83-84. Since some of the gifts were made to the trust in late December, the beneficiaries had a short time to exercise the withdrawal power. *Id.* at 83; see also *Kieckhefer v. Commissioner*, 189 F.2d at 120; *Gilmore*, 213 F.2d 520, 520-21 (6th Cir. 1954); *Stifel v. Commissioner*, 197 F.2d 107, 109 (2d Cir. 1952); *Perkins v. Commissioner*, 27 T.C. 601, 602 (1956).

96. See, e.g., *United States v. Baker*, 236 F.2d 317, 321 (4th Cir. 1956) (noting that the gifts made by the taxpayers were "equivalent to outright gifts"); see also *infra* note 189.

97. *Fondren v. Commissioner*, 324 U.S. 18, 24 (1945) (holding that a donee received a present interest only if her right was "absolute and immediate").

98. If the withdrawal power does not lapse, then the property that could have been withdrawn will be included in the power-holder's gross estate upon his death. IRC § 2041. Further, non-lapsing Crummey powers cannot be efficiently given to individuals who do not have significant interests in the trusts. Thus, without lapsing Crummey powers it would be impossible to obtain multiple annual exclusions through the use of "naked" Crummey powers. See *supra* note 21. In addition, non-lapsing withdrawal powers reduce donor's ability to control assets subsequent to the gift; thus, they are less attractive to many donors. See *infra* note 116.

The IRS proposed that the court determine whether the minors' interest in the trust was a present interest based on whether it was "likely" that the minor would exercise the withdrawal power.⁹⁹ The likelihood test urged by the IRS was based on the Second Circuit's decision in *Stifel*.¹⁰⁰ Crummey expressly rejected the likelihood test.¹⁰¹

The Crummey court also declined to adopt the Seventh Circuit's reasoning in *Kieckhefer*.¹⁰² Instead, Crummey adopted the reasoning of *Perkins v. Commissioner*, which was decided by the Tax Court in 1956.¹⁰³ Based on *Perkins*, Crummey held that a valid and enforceable demand power is a present interest, regardless of the likelihood that the power-holder would exercise the

Non-lapsing withdrawal powers are so limited that some legislative proposals to eliminate the use of Crummey powers have addressed only lapsing withdrawal powers. See supra note 28.

99. Crummey, 397 F.2d at 85; Brief for Respondent Commissioner at 10-12, Crummey (No. 21607).

100. *Stifel* held the court must consider the "surrounding circumstances" in determining whether a gift is a present interest. 197 F.2d 107, 110 (2d Cir. 1952); see supra notes 82-88 and accompanying text. *Stifel* did not explicitly state that the relevant consideration was whether it was likely that the withdrawal power would be exercised. However, the Crummey court summarized *Stifel* as holding that it created a likelihood test. Crummey, 397 F.2d at 85. As we read the *Stifel* case, it says that the court should look at the trust instrument, the law as to minors, and the financial and other circumstances of the parties. From this examination it is up to the court to determine whether it is likely that the minor beneficiary is to receive any present enjoyment of property. *Id.*

101. Crummey, 397 F.2d at 86-88.

102. *Id.* at 86. Curiously, in an action on decision released a few years after Crummey, the Service incorrectly stated that Crummey adopted the holding of *Kieckhefer*. Crummey, 397 F.2d, action on Dec., 1966-144, 1992 WL 32868 (Jan. 14, 1972). In fact, Crummey expressly rejected *Kieckhefer*, although it reached the same conclusion. Crummey, 397 F.2d at 86.

103. Crummey, 397 F.2d at 86-88 (citing *Perkins v. Commissioner*, 27 T.C. 601, 606 (1956)). In *Perkins*, the minor beneficiaries of a trust (or their guardians) had the power to withdraw funds from the trust at any time – the withdrawal powers did not lapse. 27 T.C. at 606. The *Perkins* court allowed the annual exclusions since the power was legally enforceable. *Id.* at 604-05.

power.¹⁰⁴ Based on this analysis, the Crummey court allowed all of the annual exclusions claimed by the taxpayer.¹⁰⁵

In 1972, approximately four years after Crummey, the IRS's Chief Counsel recommended that the Service acquiesce in Crummey.¹⁰⁶ The Chief Counsel noted that four circuits had adopted a position contrary to the IRS's position in Crummey.¹⁰⁷

In 1973, the IRS issued a revenue ruling embracing the holding of Crummey.¹⁰⁸ By giving a green light to the use of Crummey powers, the IRS

104. Crummey, 397 F.2d at 88 (noting that was “unlikely that any demand ever would have been made” but allowing the annual exclusions); Perkins, 27 T.C. at 606 (allowing the annual exclusions even though it was “unlikely” that the withdrawal powers would be exercised).

Of course, both *Perkins* and *Kieckhefer* allowed the exclusions claimed by the taxpayer. *Kieckhefer*, 189 F.2d at 121; *Perkins*, 27 T.C. at 605. Thus, it is unclear whether the distinction between the two cases made by the *Crummey* court has any practical relevance. However, the *Perkins* and *Kieckhefer* courts employed different analyses to reach their conclusions. These differences could be significant in other contexts.

105. Crummey, 397 F.2d at 87 (“[A]s a technical matter, we think a minor could make the demand. . . . All exclusions should be allowed under the Perkins test. . . . Under Perkins, all that is necessary is to find that the demand could not be [legally] resisted.”).

106. Crummey, 397 F.2d 82, action on dec., 1966-144, 1972 WL 32868 (Jan. 14, 1972). Shortly after Crummey was decided, the Chief Counsel's Office recommended that the IRS not file a petition for *writ of certiorari* due to the Service's other losses on the issue. Crummey, 397 F.2d 82, action on dec., 1968 WL 16563 (Aug. 19, 1968). In fact, the Service did not seek *certiorari* in any of *Kieckhefer*, *Gilmore*, *Baker* or *Crummey*.

107. Crummey, 397 F.2d 82, action on dec., 1966-144, 1972 WL 32868 (Jan. 14, 1972) (“[F]our circuits have adopted a position contrary to that of [the IRS]. . . [f]urther litigation of this issue is unwarranted.”).

The four circuits referred to are the Fourth, Sixth, Seventh and Ninth. *Id.*; *United States v. Baker*, 236 F.2d 317 (4th. Cir. 1956); *Gilmore v. Commissioner*, 213 F.2d 520 (6th Cir. 1954); *Kieckhefer v. Commissioner*, 189 F.2d 118 (7th Cir. 1951); *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

108. Rev. Rul. 73-405, 1973-2 C.B. 321. Since all taxpayers may rely on revenue rulings, issuance of the ruling established that Crummey powers may be safely used. Regs. § 601.601(e). Cf. *Dixon v. United States*, 381 U.S. 68, 72-3 (1965).

Although the revenue ruling only discusses withdrawal powers held by minor beneficiaries, the IRS has never disallowed annual exclusions based on withdrawal powers held by adults. See *supra* notes 61-74 and accompanying text.

encouraged creative attorneys to develop techniques that are more abusive¹⁰⁹ than the withdrawal powers addressed in *Crummey v. Commissioner*.

B. The Modern Crummey Power

From their innocuous beginnings in *Crummey v. Commissioner*, Crummey powers have evolved into an incredibly powerful estate planning technique. Their use, however, is subject to several technical requirements that the IRS has imposed through public and private rulings. Although these technical requirements increase the administrative burden of using Crummey powers, they do little to reduce their benefit or use.

In practice, Crummey powers operate simply. After the donor makes a gift to the trust, each of the relevant power-holders is given a right to withdraw an aliquot¹¹⁰ portion of the gift. To the extent the gift is subject to legally enforceable withdrawal powers, the donor may take advantage of the annual exclusion.¹¹¹ Shortly (frequently thirty days) after the gift is made to the trust, the withdrawal powers lapse.¹¹²

109. Of course, this statement assumes that all Crummey powers are abusive. As discussed in more detail below, this assumption is not unintentional. See *infra* notes 19, 155-80 and accompanying text.

110. Although it is not necessary that beneficiaries have equal withdrawal powers, Crummey power provisions are frequently drafted so that the beneficiaries' powers are equal.

111. *Crummey*, 397 F.2d 82, 88 (9th Cir. 19968); *Estate of Holland v. Commissioner*, 73 T.C. Memo (CCH) 3236, 3237-9 (1997). Thus, for example, under § 2503(b), if five individuals hold withdrawal powers, the donor may transfer \$55,000 to the trust free of federal gift tax. If the donor is married and the spouse consents to split the gift, then the donor could transfer twice as much (\$110,000) to the trust. See IRC § 2513.

112. Richard S. Rothberg, *Crummey Powers Enhance the Usefulness of Trusts for Minors and Life Insurance Trusts*, is *Estate Planning* 322, 323-24, (1988); Slade, *supra* note 20, at A-9.

The Service's rulings make clear its belief that a Crummey power must remain outstanding for at least thirty days, although no ruling directly addresses this issue. Mason, *supra* note 21, at 579-80; Malcolm Moore, *Tax Consequences and Uses of Crummey Withdrawal Powers: An Update*, Philip E. Heckerling 22 *Miami Inst. on Est. Plan.* ¶ 1101.1, at 11-9 (1988); Rothberg, *supra* note 112, at 323; see, e.g., Priv. Ltr. Rul. 92-23-013, Priv. Ltr. Rul. 90-30-005 (Apr. 19, 1990); Priv. Ltr. Rul. 91-31-008 (ruling that a 20 day period too severely restricted the power-holders rights). Cf. Priv. Ltr. Rul. 81-11-123 (Dec. 19, 1980) (exclusion allowed even though power lapsed 10 days after gift); Priv. Ltr. Rul. 79-22-107 (3 days). This requirement seems intuitively reasonable. Although it is possible to quibble regarding the minimum number of days, it seems beyond cavil that the beneficiary must have a meaningful opportunity to exercise her legally enforceable withdrawal power. *Crummey*, 397 F.2d at 88; *Estate of Holland*, 73 T.C. Memo (CCH) at 3237-10. A withdrawal power that remains outstanding for a short period of time, even if legally enforceable, does not provide the beneficiary with such a meaningful opportunity.

Once the Crummey powers lapse, the gifts remain in the trust and are administered according to the trust terms. Thus, for example, the trust could continue until the beneficiary reaches what the donor feels is a suitable age¹¹³ or even for the beneficiary's entire life.¹¹⁴ The donor could also arrange the trust to encourage or discourage certain behavior by the beneficiaries. The power to exercise such "dead hand"¹¹⁵ control is frequently quite attractive to donors.¹¹⁶

Although the Crummey court specifically noted that the beneficiaries were unaware of their withdrawal rights,¹¹⁷ the IRS has ruled that the beneficiaries must know of their right.¹¹⁸ As a practical matter, most attorneys recommend sending power-holders notice, called "Crummey notices," of the withdrawal power.¹¹⁹ Crummey notices are generally drafted in language that

Although no court has directly addressed the amount of time a Crummey power must remain outstanding, courts have allowed annual exclusions based on Crummey powers that lapsed after less than thirty days. See, e.g., *Estate of Cristofani v. Commissioner*, 97 T.C. 74, 78 (1991). Indeed, in *Crummey* the beneficiaries had only a few days to exercise their withdrawal powers. See *Crummey*, 397 F.2d at 83.

113. When unconstrained by tax considerations, donors frequently make gifts (including testamentary gifts) to be held in trust until the beneficiary attains age thirty-five or forty. Jerome A. Manning, et. al., *Manning on Estate Planning*, at 4-8 (Practicing Law Institute, 5th ed. 1998).

114. If trust assets are ever paid to the donor's grandchildren (or other "skip persons") then the transfer may be subject to the federal generation skipping transfer tax. See IRC §§ 2611, 2612, 2613. Although annual exclusion gifts are generally exempt from the generation-skipping transfer tax, special rules apply if the annual exclusion is obtained through the use of Crummey powers. See IRC § 2642(c); see also *infra* notes 256-57 and accompanying text.

115. The term "dead hand" is used to refer to individuals' desire to control their assets, and thereby the beneficiaries, after death. See Michael W. McConnell, *Textualism and the Dead Hand of the Past*, 66 *Geo. Wash. L. Rev.* 1127, 1127 (1998); Webster's Third New International Dictionary 579 (3d ed. 1971) (defining "dead hand" as "the influence, especially when felt to be oppressive, of the dead on the living").

116. Francis M. Nevins, Jr., *Testamentary Conditions: The Principle of Uncertainty and Religion*, 18 *St. Louis U. L.J.* 563, 563 (1974).

117. *Crummey*, 397 F.2d at 87-88; see also John L. Peschel, *Major Recent Tax Developments in Estate Planning*, U.S.C. Law Center Tax Inst. ¶ 1400, 1401.2 ("Prudent practitioners have been troubled by the . . . casual approach to the notice and time factors in *Crummey*").

More recently, in *Holland* the court suggested that whether the power-holder was aware of their withdrawal right is irrelevant. *Estate of Holland*, 73 T.C. Memo (CCH) 3237-10.

118. Rev. Rul. 81-7, 1981-1 C.B. 474.

119. See, e.g., Burke A. Christensen, *Obtaining the Annual Exclusion for Gifts, Trusts & Estates*, May 1998, at 72; Beverly J. Greenley, *The Deductible Interest Expense of the Not-So-Crummey "Crummey Trust"*, *The Tax Adviser*, August 1983, at 459, 460.

is sufficiently stilted as to make it apparent that the notice was written by the attorney.¹²⁰ Thus, Crummey notices not only notify the power-holder of the existence of the power, they also effectively, albeit silently, communicate that the power is not meant to be exercised.¹²¹ Even if the power-holder were inclined to exercise the power, he would be unlikely to risk angering the donor

The IRS has privately ruled that, in the case of a minor power-holder, the Crummey notice should be sent to an individual who has the right to exercise the withdrawal power on behalf of the minor beneficiary. Priv. Lt. Rul. 81-43-045 (July 29, 1981).

If the trustee of the trust is also a power-holder, the Service does not require that the trustee send a Crummey notice to herself. Tech. Adv. Mem. 95-32-001 Apr. 12, 1995). This is consistent with the idea that a beneficiary must have actual notice of her withdrawal power, rather than necessarily receive a Crummey notice. Estate of Holland, 73 T.C. Memo at 3237-10.

120. See, e.g., Edward F. Koren, Estate and Personal Financial Planning, 1 Est. Pers. Fin. Plan § 8.22 (2002); Joint Exhibits 21-U, 21-V, Estate of Kohlsaat v. Commissioner, 73 T.C. Memo (CCH) 2732 (1997).

Delivery of Crummey notices is similarly excessively formal. For example, in Kohlsaat, one of the trustees, Peter Kohlsaat, mailed a Crummey notice to his wife of forty years at the marital home. Joint Exhibit 21-U, Estate of Kohlsaat, 73 T.C. Memo (CCH) at 2732 (No. 22465-94); Trial Transcript at 88, 101-02, Estate of Kohlsaat, 73 T.C. Memo (CCH) at 2732. Peter Kohlsaat also sent a Crummey notice to himself. Joint Exhibit 22-V, Estate of Kohlsaat, 73 T.C. Memo (CCH) at 2732.

121. Suppose, for example, that a daughter receives a Crummey notice from the trustee of a trust created by her mother. Due to the highly formal language and delivery of the notice, the daughter will likely realize that the notice (and the right) is merely a technicality. Rothberg, *supra* note 112, at 322-23; see also Smith, *supra* note 38, at 390.

If the donor wanted the beneficiary to receive the assets outright, she would not have gone through the effort of creating the trust, making the gift to the trust, etc. Instead, the donor would simply have given the assets directly to the beneficiary. Regs. § 25.2503-3(b). Presumably, the power-holder will realize this. Moreover, if the power-holder asked the donor (or another party) about the right, the true nature of the withdrawal power would likely be revealed. See, e.g., Trial Transcript at 35-6, Estate of Kohlsaat, 73 T.C. Memo (CCH) at 2732 (noting the trial judge's skepticism regarding testimony that no conversations between the donor and the power-holders regarding the withdrawal powers took place). Even if the parties informally agreed to allow the powers to lapse, it is possible that the exclusions would be allowed. Estate of Holland, 73 T.C. Memo (CCH) at 3237-10. Cf. Fogel, *supra* note 21, at 613.

by choosing to exercise the withdrawal power.¹²² Indeed, Crummey powers are very rarely exercised.¹²³

The lapse of a Crummey power is largely irrelevant to the donor from a transfer tax viewpoint. The donor may take advantage of the annual exclusion regardless of whether the power is exercised. The lapse of a Crummey power is, however, a potentially significant transfer tax event for the power-holder. When the power lapses, the power-holder is deemed to have made a transfer of the assets he could have withdrawn.¹²⁴ Thus, the power-holder has potentially¹²⁵ made a taxable gift to the other beneficiaries of the trust, if any.¹²⁶ There are a variety of techniques to eliminate the adverse gift tax consequences to the power-holder.¹²⁷ These techniques are, for the most part, quite effective.

122. Smith, *supra* note 38, at 390; Peschel, *supra* note 19, at ¶ 1401.2; see also Jane Ann Schiltz, *Life Without Crummey*, SD85 ALI-ABA 1541, 1551 (1999) (suggesting that trusts include provisions allowing the grantor to exclude beneficiaries who have previously exercised the withdrawal power from future transfers); Karpf v. Karpf, 481 N.W.2d 891, 894-95 (Neb. 1992).

123. David Westfall, *Lapsed Powers of Withdrawal and the Income Tax*, 39 *Tax L. Rev.* 63, 65 (1983); Sherman, *supra* note 5, at 656.

124. IRC § 2514(e). Since the power-holder can, by exercising the Crummey power, appoint the property to himself, he has a general power of appointment, for federal gift tax purposes. IRC § 2514.

125. If the power-holder has the right to control trust assets after the lapse of the Crummey power, then the lapse will not be a completed gift since the power-holder still has “dominion and control” over the assets. See Regs. § 25.2511-2(a); *Priv. Ltr. Rul.* 85-17-052 (Jan. 29, 1985); *Priv. Ltr. Rul.* 82-29-097. Thus, for example, if the power-holder has a power of appointment (even a non-general power of appointment) over the trust assets, then the lapse of the Crummey power will not be a completed gift and no adverse gift tax ramifications to the power-holder ensue.

126. If the power-holder is the sole beneficiary, then lapse of a Crummey power is not a gift for want of a donee. *Priv. Ltr. Rul.* 81-42-061 (July 21, 1981).

127. The lapse of a general power of appointment, such as a Crummey power, is deemed to be a transfer of property only to the extent that the amount of the lapsed power exceeds the greater of: (i) \$5,000 or (ii) five percent of the value of the trust principal from which the power could have been satisfied. IRC § 2514(e); Regs. § 25.2514-3(c)(4). Thus, the lapse of a withdrawal power that does not exceed the “five and five” amount will not be taxed as a gift by the power-holder. IRC § 2514(e). Indeed, it is a common practice to limit Crummey powers accordingly. Rothberg, *supra* note 112, at 324-25; Slade, *supra* note 20, at A-14 – A15. A withdrawal power so limited is frequently called a “five and five” power. Rothberg, *supra* note 112, at 324.

If the withdrawal power is limited to the five and five amount, the donor will receive a similarly limited exclusion. Since the annual exclusion is currently, \$11,000 per year, limiting the power (and thus the exclusion allowed) to the five and five amount potentially wastes a portion of the allowable exclusion. *Rev. Proc.* 2001-59, 2001-52 *I.R.B.* 623. In order to obtain a greater annual exclusion for the donor, a technique called a “hanging Crummey power” may be employed. A hanging Crummey power

C. Crummey Powers After the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”)

The Economic Growth and Tax Relief Reconciliation Act of 2001 was enacted in June 2001.¹²⁸ EGTRRA is a grab-bag of tax provisions,¹²⁹ many of which were based on campaign promises made during the 2000 presidential election.¹³⁰ One of the major provisions of EGTRRA was temporary estate tax repeal, effective only for decedents dying during 2010.¹³¹

allows the power-holder(s) to withdraw the full amount covered by the annual exclusion (\$11,000). Louis S. Harrison, *Lapse of Crummey Power Need Not Result in Taxable Gift if Hanging Power is Used*, 17 *Estate Planning* 140, 141-43, (1990). The power will only lapse to the extent such lapse is covered by the five and five amount – the remaining portion that could have been withdrawn “hangs” until the next year. *Id.* Eventually the five and five amount will, as the trust size increases or when gifts are no longer made to the trust, catch up with the annual exclusion.

Another possibility is the use of naked Crummey powers. Specifically, numerous beneficiaries with little or no interest in the trust may be given Crummey withdrawal powers. See *supra* note 21. In this manner, the donor may obtain an almost limitless number of exclusions, although each will be limited to the five and five amount. IRC § 2514(e).

One particularly novel technique, called a “cascading Crummey power” attempts to create a secondary Crummey power that will allow the power-holder to take advantage of the annual exclusion in order to offset the gift caused by the lapse of his withdrawal power. See McCaffrey, *supra* note 22, at 174; Blattmacher & Slade, *supra* note 22, at 263-64. Thus, through the use of seriatim Crummey powers, no individual power-holder ever makes a taxable gift.

The legislative purpose of the five and five exclusion was to allow a donor to give the income beneficiary of a trust an additional right to receive funds from the trust. S. Rep. No. 82-382, at 7 (1951). Thus, the use of the five and five exclusion in the context of Crummey powers seems inconsistent with the Congressional intent behind the exclusion.

128. EGTRRA, *supra* note 2, 107 Stat. at 38.

129. CCH, 2001 Tax Legislation: Law, Explanation and Analysis Economic Growth and Tax Relief Reconciliation Act of 2001, at 3 (2001).

130. Richard S. Rothberg, *Impact of New Federal Tax Law?*, N.Y. L. J., Sept. 10, 2001, at 11, 11.

131. See EGTRRA *supra* note 2, 107 Stat. at 38.

EGTRRA’s sunset provision has a somewhat ignominious origin. At the time EGTRRA was passed, both the House and the Senate were narrowly under Republican control and the Republican George W. Bush was in the White House. Kathy Kristof, *Sunset Breaks Can Flame Out, Cast Lasting Glow*, Chi. Trib., July 8, 2001, at p. 3. In order to avoid a filibuster in the Senate, EGTRRA was passed as part of the budget reconciliation process. Alexander Bolton, *Senate Rule May Sunset Tax Cut*, The Hill, May 16, 2001. Under the Senate rules for the reconciliation process, a bill may be passed as a part of reconciliation only if it has no revenue effect on fiscal years after the

Although the federal gift tax was originally intended as a back-stop to the federal estate tax,¹³² repeal of the estate tax was not coupled with repeal of the gift tax. The gift tax was retained to allow it to act as a back-stop to the federal income tax.¹³³

EGTRRA changed the annual exclusion to reflect the new role of the gift tax as a back-stop to the income tax.¹³⁴ This change, reflected in section 2511(c) of the Code, is effective only for gifts made during 2010.¹³⁵ As enacted in EGTRRA, section 2511(c) provided that a transfer in trust “shall be treated as a taxable gift under section 2503, unless” the trust is treated as owned by the donor for income tax purposes (commonly called a “grantor trust”).¹³⁶

In March 2002, the Job Creation and Worker Assistance Act of 2002 amended section 2511(c). As amended, section 2511(c) provides that a transfer in trust is treated as a gift (as opposed to a taxable gift) “unless” the trust is a grantor trust.¹³⁷ The change from the term “taxable gift” to “gift” is significant.

reconciliation period. 2 U.S.C.A. § 644 (2002). Otherwise, the bill is subject to a “point of order” objection that may be overcome only by sixty or more votes. *Id.* In order to avoid such an objection, the sunset provision was included in EGTRRA.

132. See *supra* note 31.

133. CCH, *supra* note 3, at ¶ 305; see also Blattmachr & Gans, *supra* note 31, at 54.

134. IRC § 2511(c); see also *supra* text accompanying note 133.

135. Section 2511(c) of the Internal Revenue Code is effective only for gifts made after Dec. 31, 2009. See EGTRRA *supra* note 2, § 511(e), (f)(3), 115 Stat. at 71. It is repealed, along with the rest of EGTRRA, after Dec. 31, 2010. See EGTRRA *supra* note 2, § 901(a)(2), 115 Stat. at 150.

136. See EGTRRA *supra* note 2, § 511(e), 115 Stat. at 71; see also *infra* note 137.

Trusts treated as owned by the grantor for income tax purposes, are frequently called “grantor trusts.” *Black's Law Dictionary* 1516 (7th ed 1999). Depending on the terms of the trust, a trust using Crummey powers may (or may not) be a grantor trust. IRC § 678(b); Priv. Ltr. Rul. 91-41-027 (July 11, 1991). In fact, the power-holder may be treated as the owner of the trust property for income tax purposes. IRC § 678(a).

Except for the one year section 2511(c) is effective, whether the trust is a grantor trust has no effect on the availability of the annual exclusion.

137. In contrast, as originally enacted in EGTRRA, section 2511(c) provided:

(c) Treatment of certain transfers in trust. -- Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated *as a taxable gift under section 2503*, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1.” EGTRRA *supra* note 2, § 511(e), (f)(3), 115 Stat. at 71 (emphasis added).

Specifically, if a transfer is a “taxable gift,” then the annual exclusion is not available.¹³⁸ In contrast, if a transfer is a “gift,” then the annual exclusion may be used to offset the transfer.¹³⁹

As a matter of semantics, section 2511(c) is equivalent to a statement that if the trust is not a grantor trust, then transfers to the trust will be treated as gifts.¹⁴⁰ Thus, during 2010,¹⁴¹ transfers to non-grantor trusts are treated as gifts and may be eligible for the annual exclusion. Presumably, the annual exclusion may be obtained through the use of a Crummey power. Thus, even after estate tax repeal, Crummey powers remain viable.¹⁴²

The implications of section 2511(c) are less clear if the trust is a grantor trust. As mentioned, section 2511(c) provides that a transfer to a non-grantor trust is treated as a gift. It does not, however, directly address treatment of transfers to grantor trusts.¹⁴³ Thus, section 2511(c) arguably has no effect on the taxation of transfers to grantor trusts. In that case, Crummey powers would remain a viable means of making annual exclusion gifts in grantor trusts.

On the other hand, interpreting section 2511(c) to imply that transfers to a grantor trust are not gifts is consistent with the revised purpose of the gift tax. As mentioned, after estate tax repeal, the purpose of the gift tax is to act as a back-stop to the federal income tax.¹⁴⁴ As long as income earned on the gift is taxable to the grantor (i.e., is held in a grantor trust), no income tax avoidance is possible. Thus, there is little reason to impose a gift tax on such transfers. If transfers to grantor trusts are not gifts, then they are not subject to the gift tax, regardless of whether they are present interests. Thus, Crummey powers would be superfluous.

After the March 2002 amendments section 2511(c) provides:

(c) Treatment of certain transfers in trust. -- Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a *transfer of property by gift*, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1.” (emphasis added). IRC § 2511(c); Pub. L. No. 107-147, § 411(g)(1), (x), 116 Stat. 21 (Mar. 9, 2002).

138. IRC §§ 2503(a), (b).

139. *Id.*

140. E.L. Piesse & J. Gilchrist Smith, *The Elements of Drafting*, 22 (Stevens & Sons Pub. 1950) In symbolic terms, A unless B is equivalent to if not B then A.

141. See *supra* notes 2, 135.

142. But see *infra* note 145 and accompanying text.

143. Returning to symbolic logic, IRC § 2511(c) may be reduced to if not B then A. See *supra* text accompanying note 140. The converse of this statement (if B then not A) is, however, not necessarily true. Piesse & Smith, *supra* note 140, at 19.

144. See *supra* note 133.

Although Crummey powers remain effective after estate tax repeal, their use may be more limited. Many donors make lifetime gifts, frequently through Crummey powers, to decrease the estate tax that would be due if they retained the property until death. Thus, estate tax repeal may leave Crummey powers technically effective, but less useful.¹⁴⁵

In the unlikely event that estate tax repeal were made permanent, Crummey powers may become an important state estate tax planning technique. Under the current federal estate tax, the states share in the tax revenue.¹⁴⁶ Repeal of the federal estate tax thus causes significant revenue loss to the states.¹⁴⁷ Some states have already revised their estate tax statutes to assure that

145. On the other hand, annual exclusion transfers to a non-grantor trust may produce an income tax savings. Income earned on property held by a non-grantor trust would be taxable to the trust or the beneficiary, depending on the trust terms. IRC §§ 651, 652, 661, 662. Whether an income tax savings would result depends on the marginal income tax rates of the donor, the trust and the beneficiaries.

Since trust income tax rates are more sharply progressive than individual income tax rates, taxing the income to the trust is unlikely to produce a benefit. See generally IRC § 1. In contrast, if the income is taxed to the beneficiary, then it is more likely that an income tax savings may be realized.

In a nutshell, trust income will be taxed to the beneficiary if trust income is distributed to the beneficiary or if the trust is treated as owned by the beneficiary for income tax purposes. IRC §§ 652, 662, 678(a). A more detailed description of the income taxation of trusts is not appropriate here.

146. IRC § 2011. There is a credit against the federal estate tax for any estate or inheritance tax paid to a state. This "state death tax credit" is limited based on the value of the taxable estate. *Id.*

All states, even traditional tax havens such as Florida, impose an estate tax at least equal to the state death tax credit. See, e.g., Fla. Stat. § 198.02; Tex. Tax Code Ann. §§ 211.051(a), 211.055; Mo. Rev. Stat. § 145.011; N.Y. Tax Law § 952; see also Fla. Const. Art. VII, § 5(a). Generally, the state estate tax is directly tied to the credit allowable under federal law. Thus, repeal of the federal estate tax (and, obviously, the state death tax credit) costs states substantial revenue. See *infra* note 147.

Further, the state death tax credit is repealed for decedents dying after Dec. 31, 2004. IRC § 2011(f). Between Dec. 31, 2004 and the estate tax repeal, the state death tax credit is replaced with a deduction for state death taxes paid. IRC § 2058; EGTRRA *supra* note 2, § 511(e) Stat. at 71. Repeal of the state death credit eliminates state estate taxes in states that directly tie the state estate tax to the allowable federal credit. Campfield, *supra* note 31, at ¶ 1097. In effect, the federal government keeps the revenue that would have been paid to the state. Mark A. Luscombe, *Decoupling and Complexity, Taxes*, July 1, 2002 at 3. Thus, changing the credit to a deduction reduced the cost to the federal government of estate tax repeal. Roby B. Sawyers & Brian T. Whitlock, *Estates, Trusts & Gifts: Post-EGTRRA Analysis & Planning*, The Tax Adviser, Dec. 1, 2001, at 822.

147. Internal Revenue Service, *Estate Tax Returns Filed in 1996: Gross Estate by Type of Property, Deductions, Taxable Estate, Estate Tax, and Tax Credits, by Size of Gross Estate*, col. 80, available at <<<http://www.irs.gov/businesses/display/0,,i1%3D2%26genericId%3D16853,00.html>>> (noting that a total of almost \$4 billion in state death tax credits were claimed on federal estate tax returns filed in 1996); see also Luscombe, *supra* note 146.

the state estate tax survives federal estate tax repeal.¹⁴⁸ If states enact a transfer tax system that is similar to the current federal transfer tax,¹⁴⁹ Crummey powers may survive federal estate tax repeal as a state estate planning technique.

In the short term, EGTRRA may increase use of Crummey powers. Individuals may delay estate planning on the assumption that they will survive the estate tax.¹⁵⁰ If death becomes imminent, the individual may attempt to reduce the estate tax burden through last-minute estate planning techniques. Annual exclusion gifts (including gifts subject to Crummey powers) may be made up to the moment of death.¹⁵¹ Thus, the increase in last minute estate planning may yield a corresponding increase in the use of the annual exclusion and Crummey powers.

IV. A SECOND LOOK AT WITHDRAWAL POWERS

The obvious attack on Crummey powers seems to be a sham transaction (or substance over form) analysis.¹⁵² This analysis has a great deal of merit. As more fully developed below, however, it is not clear that a Crummey power must be disregarded as a sham.

Instead, Crummey powers fail to meet the basic statutory requirements for the annual exclusion. Specifically, Crummey powers operate based on the

148. See, e.g., R.I. Gen Laws § 44-22-1.1 (2001); 2002 R.I. Pub. Laws Ch. 65, Art. 16, § 2; 2001 R.I. Pub. Laws Ch. 77, Art. 7, § 3; 2002 Md. Laws ch. 440, § 7-309 (codified as Md. Code Ann. Tax-Gen. § 7-309; see also Luscombe, *supra* note 146 (noting that several states have already taken action in order to retain their estate tax, even if the federal tax is repealed); Crossfire: Why Do Some States Want to Revive the Death Tax? (CNN broadcast, Mar. 25, 2002).

The New York estate tax imposed on New York residents is equal to the federal credit in effect on July 22, 1998. N.Y. Tax Law §§ 951, 952. Although the date has been changed periodically, it seems that this provision will allow the New York estate tax to survive repeal of the federal estate tax. See, e.g., 1999 N.Y. Laws ch. 407, pt. A, § 1; see also Rothberg, *supra* note 130, at 11.

149. This seems particularly likely considering the current interrelation between the federal estate tax and the state estate tax. See *supra* note 146; but see also Luscombe, *supra* note 146 (noting that some states are considering imposing a new estate tax that is not tied to the federal tax).

150. Individuals may forego estate planning based on the incorrect assumption that the estate tax has been permanently repealed. See *supra* note 2. In the alternative, they may assume that estate tax repeal will be made permanent, which seems unlikely at this time. Rojas, *supra* note 2, at 114-1; see also David Cay Johnston, Lawyers and Accountants Expect Windfall from Estate Tax Repeal, *New York Times*, June 14, 2001, at C1 (discussing the uncertainty and confusion caused by EGTRRA).

151. John G. Steinkamp, Common Sense and the Gift Tax Annual Exclusion, 72 Neb. L. Rev. 106, 170 (1993).

152. See *supra* note 19 and accompanying text.

assumption that a power to withdraw trust assets is a present interest. As discussed below, this assumption is unwarranted. Thus, Crummey powers, although well established in the field of estate planning¹⁵³ and reluctantly accepted by the IRS,¹⁵⁴ are unsupportable as a means of obtaining the federal gift tax annual exclusion.¹⁵⁵

A. Sham Transaction

The sham transaction doctrine (and the related substance over form doctrine),¹⁵⁶ serve to prevent taxpayers from avoiding taxation through subterfuge. The doctrine is not, however, without controversy.¹⁵⁷ On the one hand, it allows taxation based on the actual transaction, rather than the labels

153. Henszey, *supra* note 19, at 76; Moore, *supra* note 112, at ¶ 1100; Richard W. Harris & Steven W. Jacobson, *Maximizing the Effectiveness of the Annual Gift Exclusion*, 70 *Taxes* 204, 204, (1992).

154. Rev. Rul. 73-405; see also Owen G. Fiore & John F. Ramsbacher, *IRS Takes a Tougher Position on Crummey Trusts in New TAM*, 23 *Est. Plan.* 413, 413 (1996) (noting that “the IRS long has been evaluating what it perceived as the taxpayer abuse represented by” the expansive use of Crummey powers); Jeffrey G. Sherman, *supra* note 5, at 656 (“[A]lthough the IRS is justified in its opposition to Crummey . . . there is no logical basis, . . . as the IRS has finally, albeit reluctantly, conceded.”).

155. Admittedly, from a practical point of view, Crummey powers are clearly viable. The IRS has acquiesced in Crummey, and has approved of their use in numerous rulings. See, e.g., Rev. Rul. 73-405; Rev. Rul. 83-108, Priv. Ltr. Rul. 78-26-050 (Mar. 29, 1078); Priv. Lt. Rul. 80-04-172 (Nov. 5, 1979); see also Regs. §§ 601.601(d)-(e). Thus, absent a seismic shift in policy it seems that even careful practitioners may assist clients in employing Crummey powers. See also *infra* notes 265-307 and accompanying text.

156. Both the sham transaction and substance over form doctrines are usually stated to be derived from *Gregory v. Helvering*, 293 U.S. 465 (1935). Compare, Karen Nelson Moore, *The Sham Transaction Doctrine: An Outmoded and Unnecessary Approach to Combating Tax Avoidance*, 41 *Fla. L. Rev.* 659, 660 (1989) with Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 *U. Chi. L. Rev.* 859, 866-67 (1982). See also Moore, *supra* note 156, at 660 (noting that the sham transaction is largely subsumed under other anti-tax-avoidance judicial doctrine).

157. Jay A. Soled, *Use of Judicial Doctrines in Resolving Transfer Tax Controversies*, 42 *B.C. L. Rev.* 587, 588 (2001).

used by the parties.¹⁵⁸ On the other, the doctrine permits overreaching as courts and the IRS stray from the Code.¹⁵⁹

Even if the requirements of the Code are met, a transaction will be disregarded as a sham unless the taxpayer actually did the “thing which the statute intended.”¹⁶⁰ For example, a transaction that met the statutory requirements for a corporate reorganization, but accomplished its sole purpose of transferring property from the corporation to a shareholder, was taxed instead as a corporate dividend.¹⁶¹

Many cases applying sham transaction analysis look for the profit motive in the transaction.¹⁶² Transactions that do not have a business purpose, other than tax avoidance, are disregarded.¹⁶³ Thus, it is difficult to apply sham transaction analysis in the gift tax context since even the most *bona fide* gift lacks a profit motive.¹⁶⁴

Nevertheless, Crummey powers seem vulnerable to an argument that they should be disregarded as shams.¹⁶⁵ Clearly, Crummey powers are used solely to garner the tax benefits of the annual exclusion. No case has considered

158. *Commissioner v. Court Holding*, 324 U.S. 331, 334 (1945) (“To permit the true nature of the transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.”); *Waterman S.S. Corp. v. Commissioner*, 430 F.2d 1185, 1193 (5th Cir. 1970), overruled on other grounds, *Utley v. Commissioner*, 906 F.2d 1033 (5th Cir. 1990). *Stewart v. Commissioner*, 714 F.2d 977, 987 (9th Cir. 1983) (noting that the sham transaction doctrine distinguishes allowable tax avoidance from prohibited tax evasion).

159. *Isenbergh*, supra note 156, at 879.

160. *Gregory*, 293 U.S. at 467.

161. *Id.*

162. See, e.g., *United Parcel Service v. Commissioner*, 254 F.2d 1014, 1018 (“This economic substance doctrine, also called the sham transaction doctrine, provides that a transaction ceases to merit tax respect when it has no ‘economic effect other than the creation of tax benefits.’”).

163. *Rice’s Toyota World, Inc. v. Commissioner*, 752 F.2d 89, 91 (4th Cir. 1985). In *Rice’s Toyota World*, the court noted that sham transaction analysis required a two-prong inquiry. A transaction will be disregarded as a sham if, first, the taxpayer was motivated only by the tax benefits and, second, objectively, no reasonable possibility of profit exists. *Id.* at 91-2.

164. *Soled*, supra note 157, at 599-601; see also *Isenbergh*, supra note 156, at 865-6 (noting that tax motivated choices are “precisely what they purport to be and therefore cannot be swept aside as shams”).

In fact, based on the difficulty of applying the sham transaction doctrine in the gift tax context, taxpayers have argued that the doctrine is inapplicable. Courts have, however, uniformly held that the sham transaction doctrine is applicable in the gift tax context. *Griffin v. United States*, 42 F. Supp. 2d. 700, 704 (W.D. Tex. 1998); *Schultz v. United States*, 493 F.2d 1225 (4th Cir. 1974).

165. See supra note 19.

the sham transaction doctrine as it relates to Crummey powers. In arguably analogous cases, however, courts have applied the sham transaction doctrine.

For example, in *Griffin v. United States*, a husband gifted 45% of his wholly owned corporation to his wife.¹⁶⁶ Shortly thereafter, both husband and wife each gave 45% of the company to a trust for the benefit of their newborn son.¹⁶⁷ The taxpayers treated the transaction as two distinct gifts of minority interests in the corporation.¹⁶⁸ In contrast, the IRS sought to treat the transaction as a single gift of 90% of the corporation, which would greatly increase the aggregate value of the gift.¹⁶⁹

The court stated that the entire arrangement was a scheme to gift 90% of the corporation, while still obtaining minority valuation discounts.¹⁷⁰ Since the exclusive motivation behind the gift to the wife was tax-avoidance, that portion of the transaction was disregarded as a sham.¹⁷¹ Thus, the transaction was treated as a single gift of 90% of the corporation.

The facts of *Griffin* are arguably analogous to a typical Crummey power situation.¹⁷² *Griffin* involved a gift by the husband to the trust using the wife as a conduit, solely for tax purposes. Similarly, in the case of a typical Crummey power, the donor makes a gift to a trust using the power-holder¹⁷³ as a conduit, solely for tax purposes. In both cases, the conduit (wife or power-holder) has the power to retain the property (or exercise the Crummey power), but there is no real expectation that she will do so.¹⁷⁴

166. *Griffin*, 42 F. Supp. 2d. at 701. No gift tax was owed on that transfer due to the gift tax marital deduction. *Id.*; IRC § 2523.

167. The wife was under no obligation to actually make the gift to the trust. *Griffin*, 42 F. Supp. 2d. at 706. Indeed, the husband “worried and feared” that his wife would decide to keep the 45% of the corporation he had given her. *Id.*

168. *Id.* Treating the transaction as two gifts of minority interests would allow the taxpayers to obtain gift tax valuation minority discounts. *Id.* at 703; *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981); Rev. Rul. 93-12.

169. *Griffin*, 42 F. Supp. 2d. at 703.

170. *Id.* at 706.

171. *Id.*

172. Indeed, the *Griffin* taxpayers relied on *Crummey*. *Id.* at 704, n. 3. The *Griffin* court, however, dismissed the taxpayer’s reliance on *Crummey*. *Id.* It noted that *Crummey* was distinguishable on its facts. Further, the issue in *Crummey* was whether the gift was a present interest, in contrast, the issue in *Griffin* was whether the transaction should be disregarded as a sham. *Id.* at 704, n. 3. But see *infra* notes 172-76.

173. Of course, the power-holder may be a beneficiary of the trust.

174. *Estate of Holland*, 73 T.C. Memo (CCH) 3236-5 (1997) 3236; *Griffin*, 42 F. Supp. 2d. at 706. In fact, in *Crummey* the court noted that it was unlikely that the powers, even though enforceable, would be exercised. 397 F.2d at 87.

Although the situations are clearly distinguishable,¹⁷⁵ Griffin held, under facts arguably analogous to a Crummey power situation, that the tax-motivated transaction should be disregarded as a sham.¹⁷⁶

In some circumstances, use of Crummey powers may be distinguished from Griffin by the extent to which the subsequent gift by the conduit (power-holder or wife) is correlated with the original gift by the donor. If the gift to the conduit is part of the donor's "explicit . . . plan"¹⁷⁷ to transfer assets to the trust, Griffin would support disregarding the power as a sham. In contrast, if the power-holder's actions are independent from the donor, then the lapse of the Crummey power may be fairly viewed as an independent gift.¹⁷⁸ In this case, the power should not be disregarded as a sham.¹⁷⁹

Analysis of whether Crummey powers should be disregarded as shams encounter the difficulty of applying the sham transaction doctrine in the gift tax context.¹⁸⁰ In a context where options with similar results are taxed differently, at what point must a taxpayer's choice of one course of action over another be disregarded as a sham? It is unclear on which side of that gray line Crummey powers fall.

B. Crummey Powers and the Statutory Requirements for the Annual Exclusion

Crummey powers rely on the unwarranted assumption that a withdrawal power is a present interest.¹⁸¹ In fact, no court has ever passed on the validity

175. Griffin, 42 F. Supp. 2d. at 702, n.3. In the Crummey power context, the issue is whether the power-holder has been given a present interest. Crummey, 397 F.2d at 83-4. In Griffin, the issue is whether severing the gift into two portions was a sham that should be disregarded. Griffin, 42 F. Supp. 2d. at 703.

176. Griffin, 42 F. Supp. 2d. at 706. Similarly, in Heyen v. United States 945 F.2d 359 (10th Cir. 1991), the Tenth Circuit disregarded as a sham a taxpayer's use of twenty-seven unrelated straw men to obtain twenty-seven additional annual exclusions for gifts to the taxpayer's family. See also Cidulka v. Commissioner, 71 T.C. Memo (CCH) 2555 (1996).

177. Griffin, 42 F. Supp. 2d. at 706. Cf. Id. at 704, n.3 (noting that Crummey was not on point).

178. Indeed, as mentioned, the power-holder has a general power of appointment, for federal gift tax purposes. IRC § 2514. Thus, subject to exceptions, the lapse of the power will, for gift tax purposes, be treated as a gift by the power-holder to the other beneficiaries of the trust. See supra notes 124-27 and accompanying text.

179. In Holland, the Tax Court held that an annual exclusion would be allowed even if the donor and power-holder had a gentlemen's agreement, that the power would be allowed to lapse. See Estate of Holland 73 T.C. Memo (CCH) at 3237-10. The author has argued that Holland was incorrectly decided. Fogel, supra note 21, at 613-616.

180. Soled, supra note 157, at 599-604; see supra notes 162-64 and accompanying text.

181. Kieckhefer, 189 F.2d at 121.

of this fundamental assumption.¹⁸² Further, the IRS has never litigated this issue.

As mentioned, the first case to directly address the use of withdrawal powers to obtain the annual exclusion was *Kieckhefer*.¹⁸³ In *Kieckhefer*, the taxpayer argued that the beneficiary's power to demand payment of the trust assets gave him "unfettered command equivalent to ownership" of the trust assets.¹⁸⁴ As detailed below, although the taxpayer's argument may have some intuitive appeal, it is specious.¹⁸⁵

In contrast, the Service framed the issue as solely dependent on the minor beneficiary's ability to exercise the demand power.¹⁸⁶ This strategy proved fatal to the Service's case. The *Kieckhefer* court felt that it was unfair to create distinctions based solely on the incapacity of the minor beneficiary.¹⁸⁷ The court was thus left with the issue ignored by the Service: whether a withdrawal power creates a present interest regardless of the power-holder's incapacity. The court, without citation, "suppose[d]" that a withdrawal power

182. See *Id.*

In *Stifel*, the court noted that the exclusions would be allowed if the power-holders were adults. 197 F.2d at 110. Since *Stifel* involved only powers held by minors, however, this statement is *dicta*. *Id.* at 110. *Stifel* denied the exclusions claimed by the taxpayer. *Id.* at 110-11.

183. See *supra* notes 61-62 and accompanying text.

184. Brief for Petitioner Taxpayer at 4,8, *Kieckhefer*, 189 F.2d 118 (No. 10301).

In its brief, the taxpayer in the section labeled "Propositions of Law Relied On" and, again, in its "Argument" section stated the issue as follows:

The right of the beneficiary of the trust to require payment to him at any time of the corpus of a trust gives him unfettered command equivalent to ownership and makes the beneficiary taxable on the income under [IRC § 61]; the same right gives the beneficiary a present interest for gift tax purposes.

Id.

185. See *infra* notes 211-19 and accompanying text.

186. Brief for Respondent Commissioner at 6, *Kieckhefer*, 189 F.2d 118 (No. 10301) ("The provision of the trust instrument permitting the infant-donee or a legally appointed guardian to make a demand for the trust property does not change this gift into a present interest. From a practical standpoint, the beneficiary, being of tender years, could not make an effective demand. . .").

187. *Kieckhefer*, 189 F.2d at 121-22.

held by an adult creates a present interest.¹⁸⁸ Thus, the claimed exclusions were allowed.

In fact, the conclusion “supposed” by Kieckhefer is incorrect. A demand power is not the equivalent of outright ownership and, more importantly, is not a present interest.¹⁸⁹

1. Section 2503 and the Treasury Department Regulations – A withdrawal power may be distinguished from a present interest on a number of different levels. The regulations define a present interest as “an unrestricted right to the immediate use, possession, or enjoyment of property.”¹⁹⁰ Based on this definition, the mere fact that a power-holder must exercise the power to

188. See *Id.* (“Suppose in the instant situation that the beneficiary had been an adult rather than a minor. Such adult, of course, could immediately have made a demand upon the trustee and have received the trust property. We suppose that such a gift unquestionably would be one of a present interest.”); see also *Stifel v. Commissioner*, 197 F.2d 107, 109-10 (2d Cir. 1952).

189. IRC § 2503(b). Of course, section 2503 does not require that the beneficiary receive outright ownership of the property. Instead, in order to obtain the annual exclusion the donor must give the beneficiary a present interest in the property. *Id.*; Regs. § 25.2503-3(b). Since the most obvious present interest is outright ownership, however, there is a great deal of overlap between the two concepts. *Baker*, 236 F.2d at 321 (discussing the annual exclusion in terms of outright ownership); Brief for Petitioner Taxpayer at 4,8, *Kieckhefer*, 189 F.2d 118 (No. 10301) (same); see also *Maxfield*, *supra* note 38, at 484 (suggesting that only outright gifts should be classified as present interests); Dept. of the Treasury, *supra* note 19, ¶¶ 461-3 (1998) (proposing limiting the annual exclusion only to outright gifts).

190. Regs. § 25.2503-3(b). The term “future interest” is used only one other time in the Code. Section 170(a)(3) provides that no charitable deduction is allowed for a gift of a “future interest in tangible personal property” unless all interests held by the taxpayer and persons related to the taxpayer have expired. IRC § 170(a)(3). Based on this language, the Tax Court has held that a taxpayer was entitled to a deduction for a gift of a 10% undivided interest in artworks to a museum. *Winokur v. Commissioner*, 90 T.C. 733, 740 (1988). Although the museum did not take possession of the artworks, the court held that possession by the museum was not required. *Id.* at 740. The court noted that the museum had the right to obtain possession of the artworks for the fractional part of the year and declined to do so without any input from the taxpayer. *Id.* Unlike in the *Crummey* power context, however, the museum’s power to possess the artworks did not lapse. *Id.*; see also *Priv. Ltr. Rul. 92-180-67* (Jan. 31, 1992). Moreover, the museum ultimately took possession of the artworks. *Winokur*, 90 T.C. at 735. It is difficult to draw conclusions regarding the annual exclusion from section 170(a)(3) due to the drastically different contexts.

obtain the property¹⁹¹ may be sufficient to defeat the immediacy required by the regulation.

Although the administrative delay is arguably sufficient to render the gift a future interest, there are shortcomings to this line of reasoning. First, the delay is presumably slight. Even in light of the United States Supreme Court's admonition that the length of the delay is irrelevant,¹⁹² it seems that the brief purely administrative delay may be disregarded.¹⁹³ Further, in determining the availability of the annual exclusion, administrative delays are sometimes disregarded. For example, a gift of an income interest in property is a present interest.¹⁹⁴ It is unlikely, however, that even the first income payment is made immediately.¹⁹⁵ Therefore, in some cases an administrative delay between the beneficiary and her enjoyment of the property does not render the gift a future interest.

A better analysis focuses on the interest actually given to the powerholder. The amount of the annual exclusion is limited to the value of the present interest given to the donee.¹⁹⁶ In the case of a withdrawal power, the donee receives a power to claim the property rather than the property itself. Thus, the allowable exclusion should be limited to the value of the withdrawal right. This valuation issue, like all others, is an issue of fact.¹⁹⁷ It is the taxpayer's burden

191. Generally, a power-holder exercises a Crummey power by delivering written notice to the trustee. See, e.g., Priv. Lt. Rul. 80-03-152 (Oct. 29, 1979) (noting that power-holders exercise the power by delivering written notice to the trustees).

192. *Fondren*, 324 U.S. at 26.

193. Perhaps the granting of a withdrawal power can be viewed as similar to the donor giving the donee a check. Certainly, the donee will confront some administrative burden and delay in converting the check to cash. It seems absurd, however, to argue that the check is a future interest. Tech. Adv. Mem. 97-08-004 (Oct. 31, 1996) (allowing exclusions for gifts made by an attorney-in-fact via check). Of course, a check, unlike a withdrawal power, is generally negotiable.

194. Regs. § 25.2053-3(b); *Fondren*, 324 U.S. at 21; *Fisher v. Commissioner*, 132 F.2d 383, 386 (9th Cir. 1942).

195. For administrative convenience, the income may be distributed to the donee at reasonable intervals, while still qualifying as a present interest. *Fisher v. Commissioner*, 45 B.T.A. 958, 963 (1941), *aff'd*, 132 F.2d 383; *Commissioner v. Lowden*, 131 F.2d 127, 128 (7th Cir. 1942); Regs. § 25.2503-3(b).

196. Regs. § 25.2503-3(b).

197. *Estate of Newhouse v. Commissioner*, 94 T.C. 193, 217 (1990); *Penn v. Commissioner*, 219 F.2d 18, 20 (9th Cir. 1955).

Generally, fair market value for tax purposes is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Regs. § 20.2031-1(b).

to demonstrate the claimed value.¹⁹⁸ Typically, the taxpayer will be unable to carry this burden; thus, no exclusions will be allowed.

Presumably, in the Crummey power context, the taxpayer will argue that the value of the withdrawal right is equal to the value of the property. If this were the case, the entire gift could potentially be offset by the annual exclusion. The taxpayer's supposed argument is, however, untenable. The value of the withdrawal power must be determined at the time of the gift, i.e., when the property is transferred to the trust.¹⁹⁹ At that time its value is highly speculative. If the power-holder exercises the withdrawal power, the value of the right should be approximately equal to the value of the property that could be withdrawn. If the power is allowed to lapse,²⁰⁰ however, it is valueless.

By assuming that the value of a power to withdraw is equal to the amount that can be withdrawn, courts (and the IRS) value all withdrawal rights, even lapsing rights, as if it were certain that the power will be exercised. Since this assumption is unjustifiable, valuation of a withdrawal power is speculative.²⁰¹ In similar circumstances, no exclusion is allowed if the value of the present interest cannot be determined.²⁰² Indeed, the United States Supreme Court has noted that the annual exclusion is unwarranted if the amount that the beneficiary receives is speculative.²⁰³ This case is no different.

198. *Disston*, 325 U.S. at 449.

199. *Eisenberg v. Commissioner*, 155 F.3d 50, 53 (2nd Cir. 1998); *Glen v. Commissioner*, 79 T.C. 208, 211 (1982).

200. Non-lapsing withdrawal powers, such as those addressed in the pre-Crummey cases, may be more credibly valued at a value equal to the underlying property. See *supra* note 27 and accompanying text.

Moreover, in the case of non-lapsing withdrawal powers, the Kieckhefer court's rationale for allowing the exclusion seems more credible. Specifically, Kieckhefer viewed the power solely as a means of facilitating gifts to minors. *Kieckhefer*, 189 F.2d at 121-2.

201. Considering the rarity of exercised withdrawal powers, the assumption that the power will be exercised seems absurd. See *supra* text accompanying notes 121-23. Consideration of such likelihood – the “likelihood of exercise” test – has been eschewed by some courts. *Crummey*, 397 F.2d at 85-6; *Estate of Holland*, 73 T.C. Memo (CCH) 3236, 3237-10 (1997).

202. *Commissioner v. Brandege*, 123 F.2d 58, 61 (1st Cir. 1941) (denying the annual exclusion because even if the gift may be called a present interest, such an interest is inherently incapable of valuation); *Brody v. Commissioner*, 19 T.C. 126, 132 (1952) (based on the specific facts of the case, holding that “the gifts of income are ‘present interests’ which can not be valued,” thus, no exclusions were allowed).

203. *Ryerson v. United States*, 312 U.S. 405, 409 (1941) (holding that “those who might become entitled to [the gifted property] were ascertainable only upon the happening of one or more uncertain future events” and, thus, the interests gifted were future interests).

The analysis described in the preceding few paragraphs may be reminiscent of the “likelihood” of exercise test described in *Stifel v. Commissioner*²⁰⁴ and explicitly rejected in *Crummey*.²⁰⁵ The likelihood of payments test requires consideration of whether it is likely that the beneficiary would exercise the power.²⁰⁶ In contrast, the analysis described herein eschews consideration of such likelihood. Instead, it is concluded that the taxpayer’s burden of demonstrating the value of the withdrawal power cannot be met due to the inherent uncertainty surrounding the exercise of the withdrawal right. Indeed, the assumption that the value of the withdrawal right is equal to the value of the underlying property is an example of the “likelihood” of exercise test because it assumes that the power-holder will exercise the power.

It is therefore submitted that the plain meaning of section 2503, the Treasury Department regulations and United States Supreme Court precedents concerning the annual exclusion, demonstrate that a gift of a withdrawal power is a future interest. Thus, *Crummey* was wrongly decided.

Admittedly, it is possible, although tenuous, to argue otherwise. Arguably, a withdrawal right may be the functional equivalent of outright ownership of the property. This disregards that the donee receives a power to vest property in himself as opposed to the actual property – a small,²⁰⁷ but significant difference. A difference that has, in fact, been dispositive in other transfer tax contexts.²⁰⁸

If *Crummey* powers can be justified at all, such justification requires an expansive reading of section 2503. Provisions of the Code granting exclusions, however, must be narrowly construed.²⁰⁹ Thus, disregarding the difference between a gift of a withdrawal power and a gift of the underlying property is inappropriate. Moreover, as detailed below, there are numerous other reasons to dismiss the tenuous argument that a withdrawal power is a present interest.²¹⁰

2. The Inapposite Income Tax Analogies – As mentioned, in *Kieckhefer* the taxpayer argued that a withdrawal power creates a present interest regardless of whether the beneficiary is a minor. Its argument was based on the

204. 197 F.2d 107 (2nd Cir. 1952).

205. *Crummey*, 397 F.2d at 85-86.

206. *Id.*; *Stifel*, 197 F.2d at 110.

207. The difference seems much more significant in the case of a lapsing power as compared to a non-lapsing withdrawal power. See *supra* note 200.

208. See *infra* notes 220-29 and accompanying text.

209. See *infra* notes 218-19 and accompanying text.

210. See *infra* notes 220-37 and accompanying text.

income tax consequences concerning withdrawal powers.²¹¹ Specifically, at that time, a holder of a demand power was taxed on the income earned by the property.²¹² Thus, the taxpayer argued, the power-holder should be treated as having received outright ownership for gift tax purposes.

Certainly, *dicta* in some of the cases cited by the Kieckhefer taxpayers support their conclusion.²¹³ These cases, however, all involve the federal income tax and the Code section defining gross income.²¹⁴ Applying these cases in the annual exclusion context requires drawing an analogy between drastically different sections of the Code.²¹⁵ Moreover, the issue in the income tax cases was whether the taxpayer had dominion over the income and whether she owned the income.²¹⁶ Such dominion or ownership is, however, irrelevant in determining whether a gift is a present interest.²¹⁷

In defining “gross income” in the Code, Congress exercised the “full measure of [its] taxing power.”²¹⁸ In contrast, federal estate and gift tax provisions have never been given such broad construction. Moreover, the

211. Brief for Petitioner Taxpayer at 4,6, Kieckhefer, 189 F.2d 118 (No. 10301). The taxpayers did cite one gift tax case – *Strekalovsky v. Delaney*. Brief for Petitioner Taxpayer at 9, Kieckhefer, 189 F.2d 118, citing, *Strekalovsky v. Delaney*, 78 F.Supp. 556 (Mass. 1948). As mentioned, however, *Strekalovsky*, is not on point. See *supra* note 60.

212. The income tax conclusion is not necessarily correct under current income tax law. See *supra* note 136.

213. See, e.g., *Jergens v. Commissioner*, 136 F.2d 497, 498 (5th Cir. 1943) (“the taxpayer was given control so absolute as to be consonant with full ownership. The trust instrument gave [the taxpayer] unlimited power to withdraw [trust assets]”); *Mallinckrodt v. Nunan*, 146 F.2d 1,3-4 (8th Cir. 1945); *Richardson v. Commissioner*, 121 F.2d 1, 2 (2nd Cir. 1941).

214. See, e.g., *Jergens*, 136 F.2d at 498 (citing 26 IRC § 22(a) (1936)). IRC § 22(a) is the predecessor to IRC § 61 of the Internal Revenue Code of 1986, as amended (the current version). Internal Revenue Act of 1954, 68A Stat. 931 (appendix).

215. Compare IRC § 61 with IRC § 2503(b).

216. *Mallinckrodt*, 146 F.2d at 4; *Russell v. Commissioner*, 45 B.T.A. 397, 401(1941) (noting that the property and income “are, in substance, [the taxpayer’s]”). See, e.g., *Jergens*, 136 F.2d at 498 (describing the issue, alternatively as whether the taxpayer had “full ownership” or “actual dominion” over the income).

217. *Fondren v. Commissioner*, 324 U.S. at 18 (1945) (noting that vesting is not the issue); *Commissioner v. Glos*, 123 F.2d 548, 550 (2d Cir. 1941).

218. *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 429 (1955); *Helvering v. Clifford*, 309 U.S. 331, 334 (1940); see also U.S. Const. amend XVI; Boris I. Bittker, A “Comprehensive Tax Base” as a Goal of Income Tax Reform, 80 Harv. L. Rev. 925, 925 (1967) (“It is no exaggeration to say that a ‘comprehensive tax base’ . . . has come to be the major organizing concept in most serious discussions of our federal income tax structure.”). Cf. Nancy H. Kaufman, Fairness and the Taxation of International Income, 29 Law & Pol’y in Int’l Bus. 145, 203 (“[W]e should stop asserting . . . that fairness in the international tax system necessitates the adoption of a worldwide tax base. . .”).

annual exclusion is a matter of “legislative grace” that is required to be narrowly construed.²¹⁹ Thus, analogy between the broadly construed income tax provision and the narrowly construed annual exclusion is inappropriate.

3. *Powers to Vest Property in Oneself in Other Transfer Tax Contexts* – Crummey powers rely on the claim that a power to withdraw property is essentially equivalent to outright ownership of the property.²²⁰ Equating a power to vest property in oneself with outright ownership of the property has, however, been rejected in some federal transfer tax contexts.²²¹

For example, in *United States v. Field*,²²² the United States Supreme Court addressed whether property subject to a general power of appointment²²³ exercised by the decedent was included in her gross estate for federal estate tax purposes.²²⁴ The Code provides (both when *Field* was decided and currently) that a decedent’s gross estate includes all property “to the extent of the interest therein of the decedent at the time of his death.”²²⁵ After considering this

219. *Stinson Estate v. United States*, 214 F.3d 846, 848 (7th Cir. 2000) (“Internal Revenue Code provisions dealing with deductions, exemptions, and exclusions are matters of legislative grace. The [annual] exclusion must be narrowly construed. . . (citations omitted)); see also *INDOPCO Inc. v. Commissioner*, 503 U.S. 79, 84 (1992) (concerning the federal income tax deduction for business expenses); *Wisely v. United States*, 893 F.2d 660, 666 (4th Cir. 1990).

220. Of course, the issue is whether the power creates a present interest. IRC § 2503(b). However, some cases discuss the issue in terms of outright ownership. See *supra* note 189. Cf. *supra* notes 216-17 and accompanying text.

221. In some cases, a power to vest property in oneself is treated similarly to outright ownership of the underlying property. See, e.g., *Heidrich v. Commissioner*, 55 T.C. 746, 752 (1971); Rev. Rul. 74-43 1974-1 C.B. 284. The power to vest property in oneself is not, however, so treated in all (or even most) cases.

222. 255 U.S. 257 (1921).

223. *Field* stated that the decedent has a “general power of appointment” over trust property, although it was not then defined in the Code or regulations. *Id.* It was later defined by the Treasury Department as a power to appoint to “any person or persons.” Regs. No. 80, art. 24 (1926) Under current law, a decedent has a general power of appointment if he has the power to appoint property to himself, his estate, his creditors or the creditors of his estate. IRC § 2041.

224. *Field*, 255 U.S. at 259. At the time the trust was created, the Code did not include an estate tax provision that specifically dealt with powers of appointment. *Field*, 255 U.S. at 264-65; Walter E. Barton & Carroll W. Browning, *Federal Income and Estate Laws* 490-91 (8th ed. 1938). The Treasury Department had promulgated a regulation that specifically stated that “property passing under a general power of appointment” must be included in the decedent’s gross estate. *Field*, 255 U.S. at 261 (citing Regs No. 37, art. XI (1917)). The Court held that the regulation was invalid. *Id.*

225. *Id.*; *Field*, 255 U.S. at 261 (citing, IRC § 202 (1916)). Section 202 of the Internal Revenue Code of 1916 has evolved into § 2033 of the Internal Revenue Code of 1986, as amended. Barton & Browning, *supra* note 224, at 482-83; Walter E. Barton,

provision, the United States Supreme Court held that the property subject to Mrs. Field's *exercised* power of appointment was not included in her gross estate.²²⁶ Similarly, in *Helvering v. Safe Deposit & Trust Company of Baltimore* ("Safe Deposit"), the United States Supreme Court held that property subject to an *unexercised* power of appointment was not included in a decedent's gross estate.²²⁷

Clearly, analogy between Crummey powers and Field and Safe Deposit is imperfect. Field and Safe Deposit both involved testamentary powers of appointment.²²⁸ In contrast, Crummey powers are exercisable during the powerholder's lifetime. Moreover, the issue in Field and Safe Deposit was whether the property subject to the power would be included in the decedent's gross estate. In contrast, the issue in Crummey is whether a withdrawal power creates a present interest in property.²²⁹

At bottom, however, both Safe Deposit and Field held that a power to vest property in oneself (or one's estate) would not be treated as the equivalent of ownership of the property. In that respect Field and Safe Deposit militate against annual exclusions based on Crummey withdrawal powers.

4. The Legislative History of the Annual Exclusion – As mentioned, the history of the annual exclusion illustrates that it was intended to "obviate the necessity of keeping an account of and reporting numerous small gifts," such

Federal Income Estate and Gift Tax Laws, 9565-7 (9th ed. 1944); Internal Revenue Code of 1954, 68A Stat. 936 (table 1). The language of the section that was relevant to Field remains the same. See IRC § 2033 ("The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.").

226. Field, 255 U.S. at 265.

227. 316 U.S. 56 (1942).

The Safe Deposit Court noted that Field left little doubt that unexercised powers, like exercised powers, would not be included in the gross estate. *Id.* at 59-60. The Safe Deposit Court did, however, also address an amendment to the Internal Revenue Code that specifically included in the gross estate "property passing under a general power of appointment exercised by the decedent." *Id.* at 62 (citing, IRC § 302(f) (1919)). This provision had been enacted, but was not effective, when the Court decided Field. Field, 255 U.S. at 264-65.

The Safe Deposit Court held that the language of the amendment to the Code addressed only exercised powers and, as mentioned, the power in Safe Deposit was not exercised by the decedent. Safe Deposit 316 U.S. at 60-61.

228. A testamentary power of appointment is exercisable by an individual after their death in their will. Black's Law Dictionary 1190-91 (7th ed. 1999).

229. Regs. § 25.2503-3(b); see also IRC § 2503(b).

as holiday and occasion gifts.²³⁰ This history supports denial of exclusions based solely on withdrawal powers.

The exclusion was intended as a rule of administrative convenience.²³¹ Instead, withdrawal powers make the annual exclusion a significant estate planning tool. Unlike the simple gifting of a holiday or occasion gift, the creation of a Crummey trust generally requires the services of an attorney.²³² A gift made using a Crummey power is more accurately viewed as part of the transmission of an estate through an attorney-created estate plan rather than the occasion gifts envisioned by Congress.

Moreover, the present interest requirement was enacted due to the “apprehended difficulty . . . in determining the number of eventual donees and the values of their respective gifts” when future interests are gifted.²³³ Annual exclusions claimed based on Crummey powers potentially exploit this difficulty. The holder of a Crummey power may not have any interest in the trust other than the withdrawal power.²³⁴ Even if the power-holder has an interest in the trust, it may not be apparent at the time the gift is made how much, if any, property will eventually be distributed to her. This is exactly the situation the present interest requirement was intended to avoid.²³⁵

Moreover, many taxpayers make full annual exclusion gifts using Crummey powers without deducting the routine occasion gifts.²³⁶ Thus,

230. H. R. Rep. No. 72-708 (1932); S. Rep. No. 72-665 (1932) (“[The annual exclusion] on one hand, is to obviate the necessity of keeping an account of and reporting numerous small gifts, and, on the other, to fix the amount sufficiently large to cover in most cases wedding and Christmas gifts and occasional gifts of relatively small amounts.”); see also S. Rep. No. 72-665, (1932) (containing language that is nearly identical to the House Report); supra notes 34-35 and accompanying text.

231. H. R. Rep. No. 72-708 (1932).

232. Bittker, supra note 32, at 451; Sherman, supra note 5, at 589-90. Although not a legal necessity, as a practical matter the creation of a trust generally requires the services of an attorney. Unif. Trust Code §§ 401, 402.

It is possible to gift a future interest without a trust. For example, a gratuitous transfer to a corporation is a future interest gift to the shareholders. *Chanin v. United States*, 393 F.2d 972, 976 (Ct. Cl. 1968); see also Note, Federal Gift Tax Exclusions: Gifts to Corporations, 6 Duke B.J. 150 (1957).

233. H. R. Rep. No. 72-708, (1932) (“The exemption does not apply with respect to a gift to any donee to whom is given a ‘future interest.’ The exemption being available only in so far as the donees are ascertainable, the denial of the exemption in the case of ‘future interests’ is dictated by the apprehended difficulty, in many instances, of determining the number of eventual donees and the value of their respective gifts.”). The Senate report contains identical language. See S. Rep. No. 72-665, (1932).

234. See supra note 21; see also Dep’t of the Treasury, supra note 19, ¶ 463 (noting that Crummey powers “undermine” the present interest requirement).

235. H. R. Rep. No. 72-708, (1932); S. Rep. No. 72-665, (1932).

236. See supra note 38.

Crummey has changed the annual exclusion from a rule of administrative convenience into an exemption that is routinely used over and above the occasion or holiday gifts.

In short, the legislative intent behind the annual exclusion is inconsistent with Crummey powers. Courts have shown a willingness to consider the legislative intent behind the annual exclusion in deciding cases in other contexts.²³⁷ There seems to be no reason to make an exception for Crummey.

5. *The Viability of Crummey v. Commissioner* – The plain language of section 2503, as well as the United States Supreme Court precedent interpreting it, do not support the use of Crummey withdrawal powers.²³⁸ In essence, Crummey confused the donee's receipt of property with the donee's receipt of a power to vest property in himself.²³⁹ It is possible to ignore this difference, as Crummey and its precedents did. As detailed above, there are, however, compelling reasons not to do so. Further, this difference is dispositive in other transfer tax contexts.²⁴⁰

The courts' erroneous decisions allowing Crummey powers may be partially attributed to the IRS's failure to litigate the fundamental validity of Crummey withdrawal powers. Even after Crummey, the issue the Service litigated (withdrawal powers held by minors) seemed far from settled. The Tax Court had repeatedly ruled in favor of the IRS.²⁴¹ Moreover, a few years after Crummey, the Tax Court noted that annual exclusions claimed based on withdrawal powers held by minors "stand on less than secure ground."²⁴² Nevertheless, Crummey caused the IRS to finally surrender the issue.²⁴³

237. See, e.g., *United States v. Pelzer*, 312 U.S. 399, 403-04 (1941) (citing, H. R. Rep. No. 72-708, (1932); denying the annual exclusions claimed by the taxpayer because "[t]he gift . . . involved the difficulties in determining the 'number of eventual donees and the value of their respective gifts' which it was the purpose of the statute to avoid"). S. Rep. No. 72-665, (1932)

238. See supra notes 181-206 and accompanying text.

239. See supra notes 206-08 and accompanying text.

240. See supra notes 220-29 and accompanying text.

241. See, e.g., *Crummey v. Commissioner*, 25 T.C. Memo (CCH) 772 T.C. Memo (RIA) 6144 (1966) rev'd, 397 F.2d 82 (9th Cir. 1968); *Gilmore v. Commissioner*, 20 T.C. 579 (1953), rev'd, 213 F.2d 520 (6th Cir. 1954); *Kieckhefer v. Commissioner*, 15 T.C. 111 (1950), rev'd, 189 F.2d 118 (7th Cir. 1951). Cf. *Perkins v. Commissioner*, 27 T.C. 601, 606 (1956).

242. *Heidrich v. Commissioner*, 55 T.C. 746, 750 n. 8 (1971). Heidrich was decided after the Ninth Circuit decided Crummey, but before the IRS issued Rev. Rul. 73-405, in which it accepted the result in Crummey.

243. See Rev. Rul. 73-405, 1973-2 C.B. 321.

When the IRS acquiesced in *Crummey*, it failed to foresee the many (arguably nefarious) uses taxpayers would make of *Crummey* powers. The Service should have realized that taxpayers would make the most of the “sham”²⁴⁴ that it sanctioned.²⁴⁵

Crummey has been the law for more than thirty years.²⁴⁶ In that time, fueled by the Service’s acceptance of the decision,²⁴⁷ *Crummey* powers have become ubiquitous. It may be too late for the IRS or the Treasury Department to rectify the mistakes made.

V. THE FUTURE OF CRUMMEY POWERS – POSSIBILITIES FOR REFORM

Although *Crummey* was wrongly decided, and the IRS’s acquiescence was short-sighted,²⁴⁸ it is unclear what can be done about the muddled state of the law concerning the annual exclusion. It seems that the best course of action is for Congress to amend section 2503 of the Code.²⁴⁹ Although the Treasury Department or the IRS may try to rectify *Crummey*, administrative action is rife with uncertainties.

A. Possibilities for Congressional Action

If Congress were to act, it would be faced with numerous choices. Certainly, there are various well-considered proposals for fundamental change in the annual exclusion.²⁵⁰ Such proposals have significant advantages. In

244. See *supra* note 19.

245. Schwidetzky, *supra* note 9, at 218 (noting that “it was predictable that taxpayers would run with the ball”).

246. *Crummey* was decided in 1968.

247. Rev. Rul. 73-405, 1973-2 C.B. 321; see also Rev. Rul. 85-88, 1985-2 C.B. 202; Rev. Rul. 81-7, 1981-1 C.B. 474.

248. See *supra* notes 190-237 and accompanying text; see also Pedrick, *supra* note 19, at 946. Schwidetzky, *supra* note 9, at 218;

249. See *infra* notes 250-264 and accompanying text.

250. For example, Professor Robert Smith has proposed severely limiting the annual exclusion and increasing the scope of the exemption under § 2503(e). Smith, *supra* note 38, at 428; Harry L. Gutman, *Reforming Federal Wealth Transfer Taxes After ERTA*, 69 Va. L. Rev. 1183, 1244-50 (1983). Under § 2503(e), gifts to pay for the donee’s educational or medical expenses are exempt from the gift tax. IRC § 2503(e). The section is, however, relatively narrow. For example, if the donor pays a student’s room and board, that payment would not be exempt from gift taxation under § 2503(e). IRC § 2503(e)(2)(A).

addition to eliminating Crummey, fundamental changes may eliminate some of the odd distinctions made under current law.²⁵¹

More limited changes are, however, also possible and have advantages. The annual exclusion has been in place in its current form since the enactment of the gift tax in 1932.²⁵² This has, for the most part, lead to a settled understanding regarding the exclusion.²⁵³ Further, it seems that whatever change is made would create new uncertainties. Moreover, there are advantages to a substantial per donee annual exclusion. Other than the Crummey issue, the annual exclusion arguably serves the purposes for which it was enacted.²⁵⁴

There is precedent supporting a limited change to the annual exclusion. Such a limited amendment to the annual exclusion has been proposed.²⁵⁵ Moreover, a limited exception aimed at Crummey powers has been enacted in other transfer tax contexts. For example, the generation-skipping transfer tax provisions dealing with annual exclusion gifts provide a limited exception that applies only to annual exclusions claimed for gifts in trust.²⁵⁶ As an oversimplification, in order for an annual exclusion gift to be exempt from the

251. *Charles v. Hassett*, 43 F. Supp. 432, 434 (D. Mass. 1942) (noting that a “layman” would be surprised to learn what constitutes a future interest as compared to what constitutes a present interest for purposes of the annual exclusion).

252. Revenue Act of 1932, Ch. 209 § 504, 47 Stat. 245, 247 (1932).

253. There are, of course, exceptions. For example, a recent case concluded that a gift of an interest in a limited liability company was not a present interest gift because the interest was subject to restrictions on transfer. *Hackl v. Commissioner*, 118 T.C. 14, 41 (2002); see also *Stinton v. United States*, 214 F.3d 846 (7th Cir. 2000); *Heringer v. Commissioner*, 235 F.2d 149 (9th Cir. 1956); *Chanin v. United States*, 393 F.2d 972, 976 (Ct. Cl. 1968) (concluding that a gift to a corporation is a future interest gift to the shareholders).

254. See *Smith*, supra note 38, at 401, supra notes 34-35 and accompanying text. Certainly a smaller, but similarly structured, exclusion might serve the same purposes. *Pedrick*, supra note 19, at 951. Further, the lesser exclusion would offer less potential for tax avoidance.

255. Joint Committee on Taxation, *Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means*, 17-87 at 269 (Comm. Print 1987); see also supra note 28 and accompanying text.

256. IRC § 2642(c) which provides that the inclusion ratio of an annual exclusion gift is zero. *Id.* Since the generation-skipping transfer tax is imposed at a flat rate of the maximum estate tax rate multiplied by the inclusion ratio, a transfer with a zero inclusion ratio is exempt from the tax. IRC §§ 2602, 2641(a).

An annual exclusion gift will not, however, get the automatic zero inclusion ratio if it is a “transfer to a trust for the benefit of an individual unless

(A) during the life of such individual, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than such individual, and

(B) if the trust does not terminate before the individual dies, the assets of such trust will be includable in the gross estate of such individual.”

IRC § 2642(c).

generation-skipping transfer tax, the beneficiary must be the sole beneficiary of the trust.²⁵⁷ This greatly limits the use of Crummey powers to avoid the generation-skipping transfer tax. Similarly, EGTRRA enacted a provision that dealt exclusively with gifts in trust.²⁵⁸ It seems possible that a similar legislative change aimed at exclusions obtained to offset a “transfer to a trust”²⁵⁹ could eliminate the abuses caused by Crummey.

Clearly, Crummey can be statutorily overruled by Congress. The current administration’s animosity toward transfer taxes,²⁶⁰ as well as transfer tax simplification,²⁶¹ seems to make legislative abrogation of Crummey unlikely. This is especially true considering that, as a political reality, the insurance lobby is likely to oppose such a change since Crummey powers are integral to life insurance trusts.²⁶²

Although legislative change seems unlikely, it is clear that Congress is the best suited to eliminate the use of Crummey powers. First, congressional action, unlike administrative action, would clearly be valid.²⁶³ Moreover, Congress seems best able to address the reliance concerns that would be raised by such a change.²⁶⁴ Lastly, Congress has the power to consider all of the possible reforms that could be made to the annual exclusion. In contrast, administrative agencies can, at most, add an anti-Crummey gloss to the language of section 2503.

257. *Id.*

258. IRC § 2511(c); EGTRRA, *supra* note 2, § 511(e), 115 Stat. at 71; *supra* notes 134-44 and accompanying text.

259. IRC § 2642(c).

260. Janet Kidd Stewart, *There’s Still Time for Year-End Tax Cheer*, *Chi. Trib.*, Dec. 17, 2000, at 3C.

261. Martin A. Sullivan, *Estate Tax Compromise or Repeal: The Rich Versus the Super Rich*, 88 *Tax Notes* 298, 299 (July 17, 2000); William M. VanDenurgh & Philip J. Harmelink, *A Bipartisan Compromise on the Estate Tax*, 90 *Tax Notes* 683, 684-85 (Jan. 29, 2001) (noting that politicians in favor of estate tax repeal are unlikely to compromise); see also Richard Neal, *Congress Should Simplify the Income Tax Laws*, *The Hill*, Apr. 10, 2002, at 52.

262. See Schwidetzky, *supra* note 9, at 232; *supra* note 20.

263. See *infra* notes 265-307 and accompanying text.

264. It seems likely that making changes prospective would adequately address most taxpayers’ reliance concerns. Some taxpayers will, however, have existing trusts with Crummey power provisions that were created with the expectation that the taxpayer would be able to make annual exclusion gifts to the trust for the indefinite future. Congress could, of course, consider whether to grandfather these existing trusts.

B. Administrative Abrogation of Crummey

The Treasury Department²⁶⁵ has not promulgated a regulation endorsing the use of Crummey powers.²⁶⁶ The Internal Revenue Service has, however, issued numerous rulings tacitly and explicitly approving Crummey powers.²⁶⁷ The Service's reluctant²⁶⁸ complicity in the use of Crummey powers has arguably made Crummey as much a part of section 2503 as if it were actually written into the statute.²⁶⁹ Thus, it is unclear whether either the Treasury Department or the IRS have the power to administratively overrule Crummey.

265. The Internal Revenue Service is a bureau in the Treasury Department. IRC §§ 7802, 7803(a); Michael I. Saltzman, *supra* note 23, ¶ 1.02. The Commissioner of Internal Revenue reports to the Secretary of the Treasury Department, which is a cabinet level position. IRC § 7803(a)(2); 31 U.S.C.A. § 301 (2000); Saltzman, *supra*, ¶ 1.02. The Internal Revenue Service is responsible for enforcing the federal tax law and collecting the proper amount owed. IRC § 7803(a)(2); Saltzman, *supra*, ¶¶ 1.01, 1.02.

266. Although the Treasury Department has never issued such a regulation, some regulations deal with situations that arise due to the prevalence of Crummey withdrawal powers. For example, the Treasury Department Regulations address the identity of the transferor (for federal generation-skipping transfer tax purposes) of a trust created by the lapse of withdrawal powers. Regs. § 26.2652-1(a)(5), ex. 5; see also Regs. § 26.2612-1(f); Regs. § 25.2503-2(e), ex. (1) and (2) (addressing the effect of an increase in the annual exclusion on withdrawal powers); Regs. § 26.2612-1(f). But see Gopman, *supra* note 27, at 201 (stating that Crummey powers have been "condoned" by the regulations).

Regulations are promulgated by the Treasury Department. Although interpretive regulations are not, under the Administrative Procedures Act, required to undergo the notice-and-comment process, the Treasury Department promulgates all permanent regulations by giving the public notice of, and opportunity to comment on, the regulations. 5 U.S.C.A. § 553(b)(A) (2000); Saltzman, *supra* note 23, ¶ 3.02[3]. These regulations are generally entitled to broad deference by the courts. *Atl. Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 389 (1998); see also *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 865-66 (1984). In contrast, rulings issued by the IRS are, generally, given little deference by the courts. *ABC Rentals of San Antonio, Inc., v. Commissioner*, 142 F.3d 1200, 1205 (10th Cir. 1998), (citing *Am. Stores Co. v. Am. Stores Ret. Plan*, 928 F.2d 986 (10th Cir. 1991) ("IRS revenue rulings are not binding on this court")).

267. See, e.g., Rev. Rul. 85-55, 1985-1 C.B. 323; Rev. Rul. 81-7, 1981-1 C.B. 474; Rev. Rul. 73-405, 1973-2 C.B. 321; Priv. Ltr. Rul. 2001-23-034 (Mar. 8, 2001); Priv. Ltr. Rul. 2000-11-055 (Dec. 15, 1999); Priv. Ltr. Rul. 78-26-050.

268. See *supra* note 154.

269. Pedrick, *supra* note 19, at 950.

I. Action by the IRS – The Service could, theoretically, revoke the public rulings endorsing Crummey²⁷⁰ and issue a new ruling pronouncing its epiphany. Taxpayers' reluctance to accept the IRS's new stance would likely lead to litigation.

The IRS's chance of success might depend on the circuit. When the Service acquiesced in Crummey, the Fourth, Fifth, Sixth and Ninth Circuits (the "Crummey Circuits") had resolved the Crummey issue against the IRS.²⁷¹ In contrast, the Second Circuit had decided the issue in the Service's favor.²⁷² The Second Circuit noted, however, that the exclusions would have been allowed, if the power-holder were an adult.²⁷³

In the Crummey Circuits, the courts would be confronted with an issue they resolved decades earlier. The courts' earlier decisions would, under the doctrine of *stare decisis*, militate against the IRS's position.²⁷⁴ Moreover, Crummey powers have become a ubiquitous estate planning tool and courts may be reluctant to disturb taxpayers' settled expectations.²⁷⁵

270. Rev. Rul. 85-55, 1985-1 C.B. 323; see also Regs. § 601.601(e) (noting that taxpayers may rely on revenue rulings unless revoked or superceded by statute, regulations or court decisions). But see *Dixon v. United States*, 381 U.S. 68, 73 (1965) (noting that the IRS's "acquiescence in an erroneous decision, published as a ruling, cannot in and of itself bar the United States from collecting a tax otherwise lawfully due"); *Vons Companies v. United States*, 51 Fed. Cl. 1, 6 (2001). Rev. Rul. 81-7 1981-1 C. B. 474; Rev. Rul. 73-405, 1973-2 C.B. 321.

Although the IRS has also issued several private rulings that approve of Crummey, private rulings are not precedent. IRC § 6110(k)(3); Regs. § 1.6661-3(b)(2); see also *Vons Companies*, 51 Fed. Cl. at 12 ("Private letter rulings . . . may not be used to support, in any fashion, an argument that one interpretation of the Code is more authoritative than another."). Thus, the Service will not need to revoke those rulings to reflect its new position.

271. *Baker*, 236 F.2d 317; *Crummey*, 397 F.2d 82; *Gilmore*, 213 F.2d 520; *Kieckhefer*, 189 F.2d 118; see also *supra* notes 61-107 and accompanying text.

The Tax Court, in contrast, had repeatedly resolved the issue in favor of the IRS. See *supra* note 242. In fact, even after *Crummey* was decided, the Tax Court expressed its agreement with the Service's position. *Heidrich v. Commissioner*, 55 T.C. 746, 750, n.8 (1971). Although the Tax Court has subsequently decided a few cases that involve Crummey powers, none of these cases involve the fundamental efficacy of Crummey withdrawal powers. See, e.g., *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991); *Estate of Kohlsaas v. Commissioner*, 73 T.C. Memo (CCH) 2732 (1997).

272. *Stifel v. Commissioner*, 197 F.2d 107 (2d Cir. 1952).

273. *Id.* at 109-10.

274. *Maislin Indus. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990).

275. See, e.g., *Jacobs Eng'g Group, Inc. v. United States*, 97-1 U.S. Tax Cas. (CCH) ¶ 50, 340, 79 A.F.T.R.2d (RIA) 97-1673, (C.D. Cal. 1997). Cf. *Pension Benefit Guar. Corp. v. R. A. Gray & Company. Oregon-Washington Carpenters-Employers Pension Trust Fund*, 467 U.S. 717, 729 (1984) ("[O]ur cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations.").

Further, despite numerous revisions to the Code, including major changes to the federal estate and gift taxes in 1976,²⁷⁶ Congress never amended section 2503 to eliminate Crummey powers.²⁷⁷ Indeed, proposals to legislatively abrogate Crummey have failed.²⁷⁸ Although it is dangerous to draw conclusions from congressional inaction,²⁷⁹ it may be interpreted as tacit acceptance of Crummey.

The analysis would be only slightly different in a circuit that had never addressed the Crummey issue. In this case, *stare decisis* would, obviously, not be an issue. Circuit courts' tendency to use precedent from other circuits would, however, partially take its place.²⁸⁰ In the Second Circuit, in contrast, *stare decisis* would militate against Crummey powers.²⁸¹

Of course, if a split in the circuits were to develop (or even if it did not), it is possible that the United States Supreme Court would grant *certiorari*. In that instance, *stare decisis* would be irrelevant since the United States Supreme Court has never addressed the Crummey issue.

There are reasons that the courts might refuse to follow the reasoning of the Crummey Circuits. Primarily, they may realize that Crummey was wrongly decided.²⁸² Even in the Crummey Circuits, *stare decisis* is not an

276. Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, 1846-97 (1976) (Title XX).

277. The United States Supreme Court has noted that Treasury Department regulations that have survived Congressional reenactment of the underlying statute get a greater degree of deference than other regulations. *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 561 (1979). A similar analysis would militate against abandoning an IRS interpretation that has survived Congressional reenactment of the underlying statute, in this case section 2503. *Maislin Indus.*, 497 U.S. at 135 ("Congress must be presumed to have been fully cognizant of this interpretation of the statutory scheme, . . . Congress did not see fit to change it when Congress carefully reexamined this area of the law . . ."). Cf. *Dixon v. United States*, 381 U.S. 68, 72 (1965) (noting that the Commissioner may retroactively correct its mistakes of law); John F. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 *Geo. Wash. L. Rev.* 35, 77-79 (1995) (noting that the assumption that Congress fully understood all statutes it reenacts is unwarranted).

278. See *supra* note 28 and accompanying text.

279. *United States v. Craft*, 535 U.S. 274, 122 S. Ct. 1414, 1425 (2002) ("[C]ongressional inaction lacks persuasive significance . . .") (citation omitted).

280. *Wash. Energy Co. v. United States*, 94 F.3d 1557, 1561 (Fed. Cir. 1996) ("[A]s the courts of appeals have long recognized, the need for uniformity of decision applies with special force in tax matters."). Desire for uniform application of the tax laws across the nation would be a powerful reason for these courts to adopt the reasoning of Crummey. *Id.* Cf. *Stifel v. Commissioner*, 197 F.2d 107 (2d Cir. 1952).

281. See *Stifel*, 197 F.2d 107. But see *supra* note 88 and accompanying text.

282. See *supra* notes 181-210 and accompanying text. The author refuses to consider the possibility that the courts may not be convinced by the analysis contained herein.

excuse to retain bad law if there is a “special justification” for overruling the earlier decision.²⁸³ The experience of the last few decades demonstrates the numerous abuses of *Crummey*. This may be a sufficient “special justification” to warrant a court’s departure from its earlier decision.²⁸⁴

As mentioned, the IRS would presumably issue a revenue ruling²⁸⁵ stating its new position that a withdrawal power does not create a present interest. Courts have, however, varied regarding the amount of deference, if

283. *Harris v. United States*, 122 S. Ct. 2406, 2414 (2002) (“*Stare decisis* is not an ‘inexorable command,’ but the doctrine is ‘of fundamental importance to the rule of law.’ Even in constitutional cases, in which *stare decisis* concerns are less pronounced, we will not overrule a precedent absent a ‘special justification.’”) (citations omitted).

Since the doctrine of *stare decisis* applies with greater force to cases involving statutory construction, the *Crummey* Circuits may be even less likely to overrule their earlier cases. See *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-73 (1989) (“Considerations of *stare decisis* have special force in the area of statutory interpretation, for here, unlike in the context of constitutional interpretation, the legislative power is implicated, and Congress remains free to alter what we have done.”).

It has been suggested that *stare decisis* considerations should be modified to include “demonstrable error” as an independent reason for overruling precedent. See, e.g., Caleb Nelson, *Stare Decisis and Demonstrably Erroneous Precedents*, 87 Va. L. Rev. 1 (2001). If this reasoning is accepted, then the *Crummey* Circuits may have yet another justification for overturning their earlier decisions.

284. In *Planned Parenthood v. Casey*, the United States Supreme Court enumerated some of its considerations in deciding whether to overrule precedent. The Court noted that

we may ask whether the rule has proven to be intolerable simply in defying practical workability; whether the rule is subject to a kind of reliance that would lend a special hardship to the consequences of overruling and add inequity to the cost of repudiation; whether related principles of law have so far developed as to have left the old rule no more than a remnant of abandoned doctrine; or whether facts have so changed, or come to be seen so differently, as to have robbed the old rule of significant application or justification.

Planned Parenthood v. Casey, 505 U.S. 833, at 854-5 (1992).

285. Revenue rulings are issued by the IRS as “official interpretations” of the Internal Revenue Code. Regs. § 601.201(a)(6). They are generally reviewed by the Treasury Department. Saltzman, *supra* note 23, ¶ 3.03[2][a]; Regs. § 601.601(d)(2). Revenue rulings are not subject to notice and comment rule making, however, the IRS considers them binding. Regs. §§ 601.601(d)-(e), 601.201(a); see also Coverdale, *supra* note 277, at 79. Cf. *Dixon v. Commissioner*, 381 U.S. 68, 72-73 (1965).

any, afforded IRS rulings.²⁸⁶ Recent United States Supreme Court cases seem to indicate that the requisite degree of deference is described in *Skidmore v. Swift & Co.* decided by the Court in 1944.²⁸⁷

286. Mitchell M. Gans, Deference and the End of Tax Practice, 36 Real Prop. Prob. & Tr. J. 731, 775-76 (2002).

Some courts have held that rulings are nothing more than the opinion of the IRS – one of the litigants. Thus, rulings are entitled to no deference. See, e.g., *Estate of Kosow*, 45 F.3d 1524, 1529 n. 4 (11th Cir.1995) (“An IRS ruling is not the product of notice and comment procedures, but is merely an opinion of an IRS attorney.”) (citing *Stubbs, Overbeck & Assoc., Inc. v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971)); *Costantino v. TRW Inc.*, 13 F.3d 969, 981 (6th Cir.1994) (“Unlike the regulations, IRS rulings do not have the force of law and are merely persuasive authority.”)

In contrast, some courts have given IRS rulings some deference. These courts have noted that, due to the Service’s expertise in administering the Internal Revenue Code, its pronouncements should be respected. See, e.g., *Foil v. Commissioner*, 920 F.2d 1196, 1201 (5th Cir.1990) (revenue rulings are “to be given weight as expressing the studied view of the agency whose duty it is to carry out the statute.”); *Brook, Inc. v. Commissioner*, 799 F.2d 833, 836 n. 4 (2d Cir.1986) (“[W]e give some weight to the Commissioner’s reading of the section, as expressed in [a revenue ruling] . . . , because it expresses the studied view of the agency whose duty it is to carry out the statute.” (citation omitted)).

287. 323 U.S. 134 (1944). But see *United States v. Mead Corp.*, 533 U.S. 218, 241 (Scalia, J., dissenting) (arguing that *Chevron* overruled *Skidmore*).

Skidmore provides a level of deference to the agency that is substantially less than the amount afforded the agency under *Chevron*. Richard J. Pierce, Jr., *Administrative Law Treatise* §§ 3.5, 3.6 (4th ed. 2002). In *Christensen v. Harris County*, the United States Supreme Court held that a statutory construction contained in an opinion letter issued by the Department of Labor was not entitled to deference under *Chevron*. 529 U.S. 576, 587 (2000). Instead, the Court held that “[i]nterpretations [such as those in opinion letters] . . . agency manuals, and enforcement guidelines, all of which lack the force of law” are entitled only to the lesser level of deference provided by *Skidmore*. *Id.* (citing *Skidmore v. Swift and Co.*, 323 U.S. 134, 140 (1944)). *Cf. Mead*, 533 U.S. at 254 (Scalia, J., dissenting) (stating that this portion of *Christensen* is *dicta*). Similarly, in *Mead* the United States Supreme Court reached the same conclusion regarding a tariff classification ruling by the United States Customs Service. 533 U.S. 218, *Id.* at 221 (citing, *Skidmore*, 323 U.S. 134); see also Richard J. Pierce, Jr., *supra*, §§ 3.5, 3.6.

It seems that *Christensen* and *Mead* require that revenue rulings be given the modest amount of *Skidmore* deference. *Cf. Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 977 (6th Cir. 1993) (“[T]his Court accords deference to Revenue Ruling . . . under the standard set forth in *Chevron*.”). Indeed, the Service agrees that revenue rulings do not have the force of law. Rev. Proc. 89-14 1989-1 C.B. 814. (“Revenue rulings . . . do not have the force and effect of Treasury Department regulations”); Coverdale, *supra* note 277, at 79.

In *Skidmore*, the United States Supreme Court held that deference given to an agency interpretation would be based on its “power to persuade.”²⁸⁸ The United States Supreme Court noted that whether the agency had been consistent in its earlier pronouncements is relevant to whether its interpretation is persuasive.²⁸⁹ The IRS’s hypothetical new ruling would be inconsistent with its long acceptance of *Crummey*. Thus, under *Skidmore*, it would probably receive little, if any, deference.

It seems unlikely that the IRS could eliminate the use of *Crummey* powers. In the *Crummey* Circuits, *stare decisis* would support the continued viability of *Crummey*.²⁹⁰ Further, although the IRS would likely issue an anti-*Crummey* ruling, it would be entitled to negligible deference by the courts. Moreover, congressional inaction and taxpayers’ settled expectations regarding the viability of *Crummey* would likely undermine the IRS’s efforts.²⁹¹

2. *Action by the Treasury Department* – The Treasury Department could attempt to end the use of *Crummey* powers by promulgating a regulation.²⁹² Most of the analysis concerning action by the IRS is the same in the case of action by the Treasury Department. The crucial difference is the degree of deference afforded to actions by each. Specifically, Treasury Department regulations are generally afforded Chevron deference as described in *Chevron v. National Resources Defenses Council*.²⁹³

In *Chevron*, the United States Supreme Court held that the courts must defer to an agency’s interpretation of the statute the agency administers if: (1) the statute is silent or ambiguous on the “precise issue” addressed by the

288. *Skidmore*, 323 U.S. at 140. *Skidmore* seems to afford a low level of deference. Samuel Issacharoff, Behavioral Decision Theory in the Court of Public Law, 87 Cornell L. Rev. 671, 677 (2002). If the court is “persuaded” that the agency’s interpretation is correct, then it seems that no amount of deference is needed for the court to adopt its analysis.

289. *Skidmore*, 323 U.S. at 140.

290. *Patterson v. Credit Union*, 491 U.S. 164, 172-3 (1989).

In contrast, in the Second Circuit *stare decisis* would support the IRS. *Stifel v. Commissioner*, 197 F.2d 107 (2d Cir. 1952). But see *supra* note 88 and accompanying text. *Stare decisis* would not be an issue in the remaining circuits.

291. *Pedrick*, *supra* note 19, at 950.

292. IRC § 7805(a).

293. *Chevron U.S.A. v. National Resources Defense Council, Inc.*, 467 U.S. 837, 865 (1984); see also *Atlantic Mutual Insurance Co. v. Commissioner*, 523 U.S. 382, 387 (1988) (applying Chevron deference to a Treasury Department regulation); *Tate & Lyle, Inc. v. Commissioner*, 87 F.3d 99, 104-105 (3d Cir. 1996); Regs. § 601.601(a)(2). Cf. *United Dominion Indus., Inc. v. United States*, 532 U.S. 822 (2001) (refusing to give Treasury Department Regulations an expansive reading based, in part, on the fact that the regulations pre-dated revision to the relevant statute). *Pierce*, *supra* note 287, § 3.5.

agency, and (2) the agency's interpretation is "based on a permissible construction of the statute."²⁹⁴ If the Treasury Department were writing on a clean slate, an interpretation of the term future interest²⁹⁵ that precludes the use of Crummey powers would clearly be a "permissible construction."²⁹⁶ Thus, the hypothetical Treasury Department regulation would be upheld.²⁹⁷

The Treasury Department is not, however, writing on a clear slate. In the Crummey Circuits, the hypothetical Treasury Department regulation would cause a conflict between two conflicting policies: Chevron deference and *stare decisis*.²⁹⁸ The United States Supreme Court has held that *stare decisis* for its decisions trumps agency regulations.²⁹⁹ The Supreme Court has not, however, addressed this issue with respect to decisions of the lower courts.³⁰⁰ Generally, lower courts have deferred to the agency's interpretation and overruled their earlier decision.³⁰¹

It seems likely that a Treasury Department regulation in abrogation of Crummey would be upheld, assuming the court decided that the Treasury

294. 467 U.S. at 843. The agency's "permissible construction" will prevail even if the court would have chosen a different interpretation of the statute. *Id.* at 843, n. 11.

295. IRC § 2503(b).

296. Chevron, 467 U.S. at 843; see also *supra* note 294 and accompanying text.

297. Chevron, 467 U.S. at 843.

298. Richard J. Pierce, Jr., Reconciling Chevron and Stare Decisis, 85 Geo. L.J. 2225, 2225-26 (1997).

299. *Lechmere v. NLRB*, 502 U.S. 527, 536-37 (1992); Pierce, *supra* note 287, § 3.6.

300. Pierce, *supra* note 298, at 2253.

301. Pierce, *supra* note 287, § 3.6. For example, the Second Circuit held that an administrative regulation that was inconsistent with an earlier decision by the same court would be upheld unless the regulation "exceeded the Secretary's authority [or is] arbitrary and capricious." *Schisler v. Sullivan*, 3 F.3d 563, 568 (2d Cir. 1993) (citation omitted).

Similarly, in *Aguirre v. INS*, the Second Circuit addressed the I.N.S.'s interpretation of a statute that was inconsistent with Second Circuit precedent. 79 F.3d 315 (2d Cir. 1996). The earlier decision, however, noted that the court's analysis was based on the plain meaning of the statute. *Jenkins v. INS*, 32 F.3d 11, 14 (2d Cir. 1994); see also Pierce, *supra* note 287, § 3.6. The Aguirre court held that the agency cannot compel the court to abandon its earlier decision, however, the court may, in light of the agency's interpretation, make "an independent decision whether . . . a revised reading of the statute" was required. *Aguirre* 79 F.3d at 317. In the interest of uniform application of the immigration laws, the court adopted the agency's interpretation. *Id.*; Pierce, *supra* note 287, § 3.6.

Similarly, in *Chemical Waste Management, Inc. v. E.P.A.*, the D.C. Court of Appeals upheld a regulation even though the regulation was inconsistent with both prior agency interpretations of the statute and decisions by that court. 873 F.2d 1477, 1481 (D.C. Cir. 1989).

Department's interpretation of the statute was permissible.³⁰² In the Crummey Circuits, *stare decisis* would complicate the issue. It seems, however, that Chevron deference may trump *stare decisis*.

On the other hand, courts may be reluctant to disturb taxpayers' settled expectations regarding Crummey powers.³⁰³ This is especially true considering the extensive use of Crummey powers in estate planning. Further, it is possible that a court would conclude that the IRS's long acquiescence in Crummey, and the Treasury Department's silence, has rendered the hypothetical Treasury Department regulation an impermissible construction of the statute. Part of the rationale for Chevron deference, however, is to allow the agency to reflect changing political environments.³⁰⁴ Thus, even though an agency's interpretation of a statute may change, the new interpretation may receive Chevron deference.³⁰⁵ Therefore, a Treasury Department regulation that adequately addresses taxpayers' reliance concerns³⁰⁶ may receive Chevron deference and end the abuse inherent in Crummey powers.

Crummey powers are, however, ubiquitous. Thus, the Treasury Department would likely be reticent to disturb such a well-settled understanding of the federal gift tax annual exclusion, even though it likely has the power to do so. Moreover, given the current administration's animosity towards transfer

302. Chevron, 467 U.S. at 843. Since an interpretation of IRC § 2503 does not permit Crummey powers is not only "permissible" but is, in fact, correct, the hypothetical regulation should meet the requirements of Chevron. See *Id.*; see supra notes 181-210 and accompanying text.

303. See supra note 275.

Action by the Treasury Department to make such a sweeping change in the law is not, however, unprecedented. For example, in 1997, the Treasury Department promulgated the "check the box" regulations that supplanted the widely criticized Kitner regulations. Treas. Reg. §§ 301.7701-2 – 301.7701-4. The Kitner regulations provided a formal set of rules to determine whether an entity is taxed as a partnership or a corporation. Treas. Reg. §§ 301.7701-2 (1996); IRS Notice 95-14 (April 3, 1995). Although the validity of the check the box regulations has been questioned, the regulations are relatively pro-taxpayer and they have not been challenged. See, e.g., William S. McKee & Mark A. Kuller, *Issues Relating to Choice of Entity, Entity Characterization And Partnership Anti-abuse Rules*, 464 PLI/TAX 9, 19-20 (2000).

304. Chevron, at 865-66. Chevron anticipated that agency attitudes may change over time because an agency, unlike the courts, is politically accountable. *Id.* In this regard, the political reality is that the current administration's attitude toward transfer taxes makes Treasury Department action unlikely. See supra notes 260-62 and accompanying text.

305. *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 742 (1996).

306. IRC § 7805(b); *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208-09 (1988). It seems possible that reliance concerns may be adequately addressed by a prospective regulation. IRC § 7805(a); see supra note 264.

taxes and transfer tax simplification,³⁰⁷ Treasury Department action seems unlikely for now.

VI. CONCLUSION

Crummey and the related withdrawal power cases were incorrectly decided. They fail to distinguish between a gift of property and a gift of a power to vest property in oneself. The difference is significant, especially considering the mandated narrow construction of the annual exclusion.³⁰⁸ The arguments in favor of allowing federal gift tax annual exclusions based on withdrawal powers are weak and rely largely on inapposite analogies to the federal income tax.³⁰⁹ Moreover, Crummey powers are wholly inconsistent with the legislative intent behind the annual exclusion.³¹⁰

The blame for the sad state of law concerning Crummey powers must be laid at the feet of the Internal Revenue Service. It never litigated the use of withdrawal powers to create a present interest and obtain the federal gift tax annual exclusion. Instead, the Service accepted the basic premise of withdrawal powers and litigated ancillary issues.³¹¹ Indeed, Crummey itself involved solely an ancillary issue: whether the power-holder must be an adult.³¹² Once the Service accepted the basic tenets behind withdrawal powers, however, it assured its loss on the ancillary issues.

The Service compounded its litigation error by acquiescing in Crummey. In acquiescing, the Service ignored that Crummey – unlike the earlier cases – involved a lapsing withdrawal power.³¹³ Moreover, the Service turned its back on its victory in the Second Circuit³¹⁴ and its repeated success

307. See supra notes 260-62 and accompanying text.

308. See supra note 219 and accompanying text.

309. See supra notes 211-19 and accompanying text.

310. See supra notes 230-37 and accompanying text.

311. See supra notes 61-79, 181-89 and accompanying text. Once the Service acquiesced in Crummey it may have precluded litigating the basic validity of withdrawal powers. See supra notes 270-91 and accompanying text. Thus, by the time of the later cases it was relegated to only litigating ancillary issues. See, e.g., *Estate of Kohlsaat v. Commissioner*, 73 T.C. Memo (CCH) 2732 (1997).

312. *Crummey v. Commissioner*, 397 F.2d 82, 83-84 (9th Cir. 1968).

313. *Gopman*, supra note 27, at 200. As mentioned, the potential for abuse in a lapsing Crummey power is substantially greater than the opportunities for tax-avoidance provided by a non-lapsing power. See supra note 98 and accompanying text.

314. *Stifel v. Commissioner*, 197 F.2d 107 (2d Cir. 1952).

in the Tax Court.³¹⁵ Indeed, the Service surrendered the issue seemingly without realizing the potential for abuse inherent in the ruse it had sanctioned.³¹⁶

A provision initially intended to exclude informal gifts has evolved into a highly structured estate planning tool. Allowing annual exclusion gifts through the use of Crummey powers may seem a minor side-step of congressional intent. This fails, however, to account for the varied uses of Crummey powers. For example, skillful use of Crummey powers allow taxpayers to multiply the number of exclusions almost without limit.³¹⁷ Indeed, Crummey powers have the potential to undermine the entire transfer tax system.³¹⁸

Abrogation of the use of Crummey powers is necessary. It seems that a considered congressional response in this area would be the best course of action.³¹⁹ Admittedly, however, congressional action to eliminate Crummey is currently unlikely. A Treasury Department regulation that sought to eliminate Crummey powers would likely be given effect, despite inconsistent court precedent. However, Treasury Department action in this area is also currently unlikely.

It seems that the Service may be stuck with Crummey powers. Although the Service can revoke its earlier rulings and begin litigating the withdrawal powers issue anew, its chances for success in this regard are slim. Thus, absent action by Congress or the Treasury Department, the IRS will be forced to lie in the bed it made for itself decades ago.

Regardless of the future of the federal estate tax, the federal gift tax and the annual exclusion seem likely to remain a part of the federal transfer tax system for the foreseeable future. Indeed, recent changes to the estate tax may, in the short term, increase the use of the annual exclusion and Crummey powers.³²⁰ Perhaps such use will eventually convince Congress or the Treasury Department to act. Until they do, the homonym that has amused many familiar with Crummey powers³²¹ will continue to be both amusing and, sadly, accurate.

315. See supra note 242 and accompanying text. Even after Crummey, the Tax Court expressed, albeit in *dicta*, its continued reticence to accept Crummey powers. *Heidrich v. Commissioner*, 55 T.C. 746, 753, n. 8 (1971).

316. See supra note 244 and accompanying text.

317. Mason, supra note 21, at 593. This is accomplished by giving Crummey powers to numerous individuals with little or no interest in the trust. See supra note 21.

318. Commissioner's Brief at 19, *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991) (No. 28538-89).

319. See supra notes 250-64 and accompanying text.

320. See supra notes 150-51 and accompanying text.

321. See, e.g., L. Henry Gissel, Jr., *Has Crummey Turned Lousy? Not Yet According to Kohlsaat!*, SC13 ALI-ABA 265, 265 (1997); Gregory M. McCoskey, *Why Relying on Cristofani to Draft Trust Withdrawal Powers is a "Crummey" Idea*, Fla. B. J., July/Aug. 1997 at 67. Pedrick, supra note 19, at 943 ("Crummey is really crummy!").