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60. 20-3B-5.
60. 71 P.S. 510-4.

60. Id at 19-20.
60. Id at 21-22.
60. Id at 15-16.
60. Id at 27-30.
60. David Brown, Executive Director of America Outdoors of Knoxville, Tennessee, a trade association of over three hundred members, says that the risk of death is 1 in 300,000 to 1 in 900,000. For example, one million persons have rafted the Ogee River in Tennessee since 1977 with only one fatality. The Ogee is a moderate Class III river with a few Class IV or “difficult rapids.” By contrast, the National Ski Patrol Associations places injuries at 4.5 for each 1,000 skiers. Id.

THE LIFE INSURANCE TRUST: A “NO-BRAINER” FOR SAVING ESTATE TAXES *

by

Introduction

Martin H. Zern**

Life insurance is a unique asset. In essence, it is a contractual arrangement whereby an insurer pays a stipulated amount to a named beneficiary upon the insured’s death in exchange for premium payments while the insured is alive. It is unique in that its value (face amount) is born only upon someone’s death. Before that event, the policy may have no value, as in the case of term insurance, or some value, as in the case of whole life (permanent) insurance. The value of permanent insurance while a person is alive is commonly referred to as its cash surrender value or more accurately its interpolated terminal reserve value. Regardless of what value, if any, a life insurance policy has while the insured is alive, when he dies, the policy immediately is worth whatever is set forth on its face. No other asset increases in value from one moment to the next, life to death, so much as life insurance does. Fortunately, the amount received under a life insurance contract, whether in a single sum or otherwise, generally is excluded from income taxation if it is paid by reason of the death of the insured. This exclusion also means that there is no income tax on the internal buildup of income while the insured is alive. Unfortunately, however, there is no automatic exclusion of the proceeds of a life insurance policy from federal estate taxation. Quite to the contrary, without proper planning, the proceeds of life insurance are includible in the gross estate of the insured and consequently could be subject to the federal estate tax. Moreover, the estate tax rates are significantly higher than the income tax rates, effectively beginning at 37% and topping out at 55% where and to the extent the taxable base exceeds $3,000,000. If a state (such as New York) imposes an estate tax that is higher than the statutory credit allowed in computing the federal estate tax, the overall rate is even higher. However, as those somewhat familiar with estate taxation are aware, no federal estate tax is due unless the taxable base exceeds $600,000. Inclusion of life insurance proceeds could bring an estate over this threshold, or increase the amount already subject

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to the estate tax.

For many estates, particularly those with a high percentage of illiquid assets (e.g., family business, real estate, securities that it is desirable not to sell), the federal estate tax is a big problem due to the fact that the tax is generally due within nine months after the date of the decedent's death. Although the executor is primarily responsible for payment of the tax, if it is not paid when due for whatever reason, there is transferee liability imposed upon the person who receives property which has been included in the gross estate. Insurance is often the means by which the estate, or those beneficiaries who may be subject to transferee liability, acquire the means to pay the tax. If the reason for carrying insurance is to pay estate taxes, permanent insurance should be chosen since term insurance gets increasingly expensive as one gets older and may not be available after a certain age. If the insurance is held by an irrevocable trust, as discussed later in this paper, the trust will typically give the trustee administrative powers to purchase property from the estate and to make loans to it, which the trustee could do if there is an estate liquidity problem.

Estate Inclusion

For estate tax purposes, the amount receivable under a life insurance policy upon the death of the insured (the decedent) is includible in the decedent’s gross estate if the amount is receivable by his executor or, if receivable by other beneficiaries, where the decedent held any of the “incidents of ownership” in the policy.

Receivable by the Executor

Life insurance proceeds paid with respect to the death of a person are includible in his gross estate if receivable by the executor or administrator of his estate, or if the proceeds are payable to his estate. Moreover, it is not necessary for the estate to be specifically named the beneficiary. For instance, if the proceeds are payable to another beneficiary who is legally bound under the policy to pay taxes, debts or other obligations of the estate, then the amount of insurance proceeds required to be used to discharge such obligations is includible in the gross estate. Similarly, if the insurance was purchased by the decedent as collateral security for a loan, the proceeds are includible in his gross estate even though received by the lender.

Incidents of Ownership

Regardless of who the “other beneficiaries” may be, the amount receivable by any beneficiary, where the face of the policy is paid because of the decedent’s death, is includible in the decedent’s gross estate if the decedent held at death any of the incidents of ownership in the policy, exercisable either alone or with the approval of any other person.

The term “incidents of ownership” is not limited to technical ownership in the legal sense. Fundamentally, the term relates to the insured’s control over the economic benefits of the policy. Accordingly, it includes, among other things, the powers to:

(a) Change the beneficiary.
(b) Surrender or cancel the policy.
(c) Assign the policy or revoke an assignment.
(d) Pledge the policy for a loan.
(e) Determine a settlement option.
(f) Obtain a loan against the cash surrender value.

A decedent may also have “incidents of ownership” in a policy on his life owned by a corporation if the decedent was the sole or controlling stockholder. This rule would be applicable where any part of the proceeds of a policy are not payable to the corporation (e.g., the proceeds are payable to the decedent’s son) and thus would not be taken into account in valuing the decedent’s stock in the corporation. The term “incidents of ownership” also includes a reversionary interest where the value of the reversionary interest exceeds 5% of the value of the policy immediately before the decedent’s death.

Further, a decedent may hold “incidents of ownership” with respect to a policy on his life held in trust if, under the policy, the decedent (either alone or with another or others) had the power (as trustee or otherwise) to change (a) the beneficial ownership in the policy or its proceeds, or (b) the time or manner of enjoyment thereof, even though the decedent had no beneficial interest in the trust.

It is important to recognize that in addition to having “incidents of ownership,” the decedent must be the insured in order for the proceeds of life insurance to be includible in his gross estate. For example, if a husband owns a policy on his wife’s life (or on the life of any other person), the amount includible in his estate if he is first to die will be only the cash surrender value of the policy, if any.

Impact

If insurance is included in the gross estate, it will be subject to estate tax and the beneficiaries consequently will get that much less. So, any worthwhile estate plan should provide for the insurance not to be included in the gross estate. Example: A, the insured, dies with a taxable base apart from insurance of $1,000,000. Insurance payable by reason of his death is $200,000. The federal estate tax with the insurance included in A’s gross estate is $235,000 and without is $153,000. By excluding the insurance from the gross estate, the full amount of the insurance is available to pay the estate tax without it in turn being subject to the estate tax. Thus, the objects of the decedent’s bounty wind up with an additional $82,000.
Effect of the Marital Deduction

If the deceased owner/insured is married, the unlimited marital deduction will eliminate the insurance proceeds from taxation in his estate if his spouse is the beneficiary.

However, this will result in the insurance proceeds being included in the estate of the surviving spouse, if not consumed or given away during her lifetime. Even if an amount equal to the insurance proceeds is consumed or given away, this will simply mean that other assets of an equivalent amount would have been expended if there were no insurance will not be expended. Thus, with insurance included in the survivor’s estate, an estate tax might be imposed where otherwise there would be none, or an estate already subject to tax will be that much greater.

Lifetime Exemption

It must be recognized, of course, that the surviving spouse will not be subject to estate tax unless her taxable estate, including the insurance proceeds, exceeds $500,000.

There are many possibilities. For example, she may, before her husband’s death, already have net assets in her own name exceeding $600,000; she may have nothing in her name, or perhaps have net assets valued under $600,000, and the insurance proceeds alone, or together with whatever else was left to her, will bring her taxable estate to over $600,000; or, she may have some or no assets and the insurance proceeds, and whatever else was left to her, will not bring her taxable estate to over $600,000. Even if her assets after her husband’s death (including the insurance) wind up under $600,000, appreciation and reinvested income during her lifetime may bring her over the $600,000 benchmark.

Whether she will need the insurance money to live on will depend upon her standard of living, the needs of her family and the liquidity of what she yields up with. For example, if after her husband’s death, she winds up with the family home worth $450,000 (free and clear) and $250,000 of liquid assets, including insurance proceeds, she may need the $250,000 and may consume all or most of it while alive. On the other hand, she may have a good paying job and not consume the $250,000, intending to leave it as a fund for her children. Thus, disregarding potential appreciation or decline in value after her husband’s death, she would wind up with an estate of $700,000 ($450,000 + $250,000) which would result in estate tax to be paid. Another possibility is that she might die prematurely before getting a chance to expend the insurance money where it was expected that she would do so. These are by no means all the possible scenarios. There is, for example, the capability of making annual gifts within the annual $10,000 per donee gift tax exclusion to deplete her estate. However, the point is made that the insurance left to her will add to her assets and either could cause her to be subject to the federal estate tax where she otherwise would have been below the $600,000 threshold at her death, or will increase the estate tax that she would owe where, without the insurance, she was already over the threshold. Even if she dies owing less than $600,000 and not owing any federal estate tax, she might nevertheless owe increased state estate taxes because of the insurance.

Second-to-Die Insurance

Therefore, unless we are dealing with relatively small amounts, it is generally not a good idea to have insurance proceeds payable outright to the surviving spouse where there is a good chance that she will be subject to estate taxation. Even where it is expected the survivor will consume the insurance proceeds, or deplete the estate to under $600,000 utilizing the $10,000 gift tax exclusion, an early fortuitous death may interpose.

As between a husband and a wife, it may be noted that it makes no difference for estate tax purposes whether the insurance policy is owned by the insured spouse or the other spouse where the other spouse is the beneficiary. If, for instance, a wife owns a policy on her husband’s life and she is the beneficiary, she will collect the proceeds upon his death and nothing will be included in his estate since he is not the owner. If he is the owner and she the beneficiary, the proceeds includible in his gross estate will be offset by the marital deduction.

It should be recognized that the marital deduction will eliminate the estate tax in the estate of the insured only if the surviving spouse who is the beneficiary survives the insured. If not, the proceeds will be includible in the estate of the insured, assuming he has “incidents of ownership.”

Cross-ownership

In certain cases, both husband and wife may desire to carry significant amounts of insurance on their respective lives naming each other beneficiary, with their children (possibly minors) as secondary beneficiaries. Both spouses may be working and have significant income and possibly assets. Their overall intention is to provide a fund for their children in the event of both of their premature (and possibly simultaneous) deaths, or to make available additional funds to the survivor where one dies before the other. For example, say two professionals, husband and wife, each own a $1,000,000 policy with the other spouse named as beneficiary, and the children as secondary beneficiaries. If the husband dies prematurely, the wife will have added to her assets $1,000,000, and vice versa. (The marital deduction would offset the $1,000,000 included in the estate of the first to die.) If she died shortly thereafter, another $1,000,000 would go into her gross estate, so that she would wind up with $2,000,000. This amount would, of course, be in addition to whatever else was in her gross estate. Although there might be some slowdown if she survived awhile after her husband’s death, this would simply mean that other funds would not be expended. Or, if there were a common accident, where the order of death could not be determined, and no will clause containing an assumption as to the order of death, generally $1,000,000 would wind up going into the estate of each spouse. The estate taxes imposed on the insurance would thus erode the amount available for the children, or to be held for their benefit if they are minors.

Second-to-Die Insurance

Where there will be no estate tax on the estate of the first spouse to die because of bypass planning and use of the 100% marital deduction, a type of insurance commonly
called “second-to-die” or “survivorship” insurance is usually preferred, if for no other reason than it is less costly. This type of insurance might be selected where it is expected the surviving spouse will have sufficient assets (after her husband’s death) to meet family needs without insurance. The policy would be payable only upon her death with the purpose of financing the estate tax due on her estate, and/or possibly to provide additional funds for children who are still minors, disabled in some manner or otherwise incapable of full self support. Here too, the goal is to exclude the insurance proceeds from the survivor’s gross estate.

Having Your Cake and Eating it too

It is possible to eliminate life insurance proceeds from the gross estate of the insured yet have the proceeds utilized as the insured desires. The key is to make sure the insured, at death, does not possess any “incidents of ownership” in the life insurance policy. As discussed hereafter, the techniques for attaining this result are to have the policy owned either by another individual directly or by an irrevocable trust.

Direct Ownership by Another

One approach for eliminating “incidents of ownership” at death is for someone other than the insured to own the policy. A typical scenario is for a child to directly take out the policy on the life of the parent naming himself as the beneficiary. The policy could be a single life policy or a joint-and-survivor policy. Since the parent never owned the policy, it will not be included in his estate, or the estate of the survivor if a joint-and-survivor policy. When the parent dies (or the survivor), the proceeds will be collected by the child without any estate tax being imposed. This plan might be viable, for example, where the child is a mature adult and has an economic interest in the parent such as where there is a family business. Generally, a child cannot take out a policy on the life of a parent unless the parent applies for or consents in writing to the making of the insurance contract.

If a child owns the policy, consideration must be given to how the premiums will be paid. Of course, the child may have sufficient assets of his own to pay the premiums. On the other hand, it may be desirable or necessary for the parent to pay the premiums directly to the insurance company or to give funds to the child to make payment. Either way, the gift of the premium should not be taxable as long as it does not exceed the $10,000 annual gift tax exclusion. On a split gift, the amount could be $20,000. Of course, funds should be given to the child to pay the premiums only if the child is trustworthy to do so.

Difficulties arise if it is desired to have more than one child own the policy and the parent pays the premium. Because no one child has the capability of exercising ownership rights without the other, it may be construed that no child has a present interest. Thus, the payment of the premium by the parent might not qualify for the annual gift tax exclusion. The seemingly obvious answer to this dilemma is to make gifts to each of the children so that they can pay the premium. In this regard, each gift would qualify for the $10,000 annual exclusion. Here again, however, the issue of trustworthiness is a factor compounded by the fact that there is more than one child to rely on. Also, where there are multiple owners everyone must agree concerning exercise of ownership rights, which could be a problem especially if one of the owners becomes incompetent. Multiple owners may also be treated as owning the policy with survivorship rights, unless clearly spelled out otherwise. Thus, the issue of a deceased owner will be cut off which may not be what was intended. Multiple policies, that is a separate policy to each child, may be a possibility. However, this generally would be more expensive.

Another possibility where there is more than one child is to have only one own the policy and have all as beneficiaries. Apart from the problem of the owner perhaps surreptitiously changing the beneficiaries and excluding his siblings, there could be adverse gift tax consequences when the parent dies. Since the owner has the right to change beneficiaries, his failure to do so might be construed by the IRS to constitute a gift of the proceeds at death to the extent of the share of the other beneficiaries. Consequently, this arrangement should be avoided.

As noted previously, life insurance is excluded from the gross estate of the insured if the spouse of the insured is the owner of the policy. However, where it is desired to keep the proceeds out of the surviving spouse’s gross estate for estate tax reasons, the solution is the irrevocable life insurance trust. If the surviving spouse carries insurance on her life, it may be desirable to have such insurance also owned by a trust (or another person individually) in order to keep these further proceeds out of her gross estate.

A disadvantage of direct ownership of the policy by another is the fact that the value of the policy before death of the insured, and the proceeds after death, could be at risk with respect to creditors of the owner/beneficiary, although certain exemptions are usually provided under state law. A further danger is potential claims by a spouse against the owner/beneficiary in the context of a divorce proceeding. Also, individual ownership permits taking a loan against the policy or letting it lapse. This could be done without the consent or knowledge of the insured who is providing the funds to pay the premiums.

Ownership by an Irrevocable Life Insurance Trust - A Better Idea

As is the case with ownership of a life insurance policy by a child, children or a spouse, ownership by an irrevocable life insurance trust will shield life insurance proceeds from estate taxation in the estate of the insured. The irrevocable life insurance trust should always be considered where there are minor children or where the insured does not want children to obtain the funds outright until a “mature” age. It also permits flexibility in managing the insurance proceeds and controlling its disposition. For instance, the insured may not wish his spouse to be the direct beneficiary if there are concerns about her management capability or that she might dissipate the insurance proceeds to the detriment of the children (who possibly may be the children of the insured from a prior marriage). A
trust also can contain "spendthrift" provisions and the trustee may be given authority to "spinkle" income and principal among multiple beneficiaries. In this context, the problems of direct ownership by multiple beneficiaries, noted above, is avoided. A trustee with management and investment acumen can be selected to oversee the trust.

Moreover, a life insurance trust will keep the proceeds out of the gross estate of a surviving spouse, yet could permit her a certain amount of control over the disposition of the proceeds. A result, the entire insurance, with no diminution by estate taxes either in the estate of the insured or his spouse, will be available for use by the surviving spouse and/or the children.

An irrevocable life insurance trust is an inter vivos trust. In most cases it is an unfunded trust and may be viewed as a standby vehicle awaiting the death of the insured for funding with the insurance proceeds (and possibly with other assets). Ideally, the trustee initiates the policy because of the "three-year" rule, discussed below. The grantor/insured transfers funds to the trust each year in an amount sufficient to pay the premium. Rather than annual transfers, another possibility is for the grantor/insured to initially transfer assets into the trust in an amount sufficient to generate enough income to pay the premium. This latter arrangement, known as a funded trust, is generally undesirable. For one thing, people usually are reluctant to give up control of a significant amount of assets, which would be necessary for the trust to earn the income to pay the premium. Another deterrent is that the amount necessary to fund the trust will create a taxable gift requiring payment of a gift tax by the donor or, if any of it is still available, use of his unified credit. Furthermore, an income tax consequence is that, even though a trust is irrevocable, the income generated by the assets in the trust and used to pay premiums is taxable to the grantor.

As explained above, with an unfunded trust, the grantor/insured transfers funds into the trust each year in an amount sufficient for the trustee to pay the premium. Although in substance the grantor/insured is paying the premium, the proceeds will not be included in his estate provided he retains no "incidents of ownership" in the policy. Because the beneficiaries will not receive anything until the grantor/insured dies, the contribution to the trust to pay the premium is a "future interest" insofar as they are concerned. Consequently, the contribution to the trust each year of the premium amount will not, without special language in the trust, qualify for the annual $10,000 per donee gift tax exclusion, which requires a gift of a "present interest." Likewise, a direct payment to the insurance company by the grantor/insured will not qualify for the annual exclusion. As previously noted, a $20,000 annual exclusion per donee is available where a husband and wife make a "split gift" election. Under such an election, the gift is treated as coming 1/2 from each spouse, resulting in two exclusions, even though it comes from only one.

The Crummey Charade

To obtain the benefit of the annual gift tax exclusion for the contribution to the trust to pay the premium, the trust must contain special language giving the beneficiary(ies) certain withdrawal rights as to the contribution. Such withdrawal rights create a present interest in the beneficiary(ies). In Crummey v. Commissioner, Clifford Crummey, who had established an irrevocable trust for his four children, triumphed against the IRS in his contention that each beneficiary's right to possession (to appoint property to himself) of a share of the amount transferred to the trust was equal to actual possession of such share, thus qualifying the amount transferred as a present interest for purposes of the annual gift tax exclusion. The court so held despite the fact that the right to possession was limited in duration and that those beneficiaries who were minors could only assert their right through a guardian. The IRS had not denied an exclusion for the adult beneficiaries. The fact that a guardian may not in fact be appointed was subsequently conceded by the IRS not to be a problem provided there was no impediment under the trust or local law to the appointment of one.

As a result of the Crummey decision, the standard irrevocable life insurance trust contains so-called Crummey powers. These powers seemingly will qualify an amount transferred to a trust as a present interest for purposes of the annual exclusion even though the power of a beneficiary to withdraw the amount is limited in duration and despite the fact that the beneficiary is a minor and no guardian has been appointed. The power to withdraw, even though short-lived, has been held legally sufficient to create a present interest although arguably it is illusory. The fact of the matter is that the amount transferred to the trust to pay the premium is rarely, if ever, withdrawn by anyone. The reality is that the money is needed to pay the premium. If a beneficiary withdrew the amount, unless paid otherwise, the policy would lapse which would be self-defeating to the beneficiary. Moreover, the beneficiary also recognizes that a withdrawal might result in the grantor making no further contributions. In many, if not most, life insurance trusts, the beneficiaries are the grantor's children. One can just imagine a parent's reaction if a child withdrew the money from the trust that the parent just put in to pay the premium. With respect to minor children, the possibility of the money being withdrawn by a guardian is less than minimal. Overall, it is implicit that withdrawal will not be made. It is surprising, therefore, that the courts and the IRS, at least so far, have sanctioned this charade, and that practitioners seemingly have little concern that the apple cart will be overturned.

Multiplying the Exclusion

The $10,000 exclusion is multiplied by each gift of a present interest. Thus, if there are multiple beneficiaries of a trust, the total amount that can be excluded is $10,000 times the number of beneficiaries who have Crummey withdrawal powers. For instance, if there are four such beneficiaries, the grantor could annually transfer $40,000 into the trust as a non-taxable gift. Of course, whether such a sum needs to be protected by the exclusion depends upon the amount of the annual insurance premium. (It may be desirable to make gifts to the trust in general and not merely to pay the premium.) In determining
how many $10,000 exclusions are available, it was always clear that you count the number of primary beneficiaries and not those with only a nominal interest, such as a contingent remainder. This rule was upset a few years ago by the Tax Court in Estate of Maria Cristofani. In Cristofani, the IRS allowed exclusions for the two children of the grantor who were primary beneficiaries but disallowed them for the grantor’s five grandchildren who had only contingent interests in that they were to receive principal distributions only if their parents (the primary beneficiaries) died before termination of the trust. The somewhat circular argument of the IRS was that since it was unlikely that the grandchildren would get anything, they would normally exercise their withdrawal rights unless there was a prior understanding that they would not do so. However, the court ruled that the test of a Crummey power is the “right to demand property” from the trust “not the likelihood” of exercising that power. Thus, the court allowed an annual $10,000 exclusion for all the beneficiaries including the grandchildren, adding up to seven exclusions. It may be noted that the right of the beneficiaries to withdraw existed only for 15 days following the grantor’s contribution to the trust. Although the case at first impression appears favorable, at least in the 9th Circuit which sanctioned the result, commentators fear that the case may have brought undue attention to Crummey powers in general, and that Congress consequently might enact restrictive legislation on their overall use, not only where there are contingent beneficiaries. It should be recognized, of course, that in many if not most cases, it is not necessary to obtain multiple exclusions since the amount necessary to pay the premium may be below $10,000.

Timely and Adequate Notice

A beneficiary’s right of withdrawal under a trust agreement with respect to contributions to the trust to pay premiums must be perfected by notice of such right in order for it to constitute a present interest in the contribution. Generally, the right to withdraw is given for a specific period of time after which it lapses. The time period must be reasonable and begins when notice of the withdrawal right is received by the beneficiary. However, what constitutes a reasonable time is somewhat uncertain. Most practitioners feel that at least 30 days’ notice is sufficient and this seems to be the standard, although the courts have sanctioned a lesser time, such as the 15 days in Cristofani, supra. There seemingly is no good reason to take a risk and provide for less than 30 days notice in the trust document considering that in most cases withdrawal is highly unlikely regardless of how much time is given. If the premium is due and paid prior to the end of the withdrawal period, at which time the power to withdraw lapses, the right to withdraw may be considered illusory. Consequently, the premium amount should be contributed to the trust sufficiently in advance of its due date to allow for notice of the right to withdraw to be sent and received and the withdrawal time to pass. However, if the policy is one of permanent insurance, as opposed to term, it appears that the cash to pay the premium need not be retained for any period of time and the trustee could thus pay the premium immediately. Under this rationale, the withdrawal rights could be given once a year at a fixed time, for example, 30 days before year end to terminate at year end. However, if the trust is created shortly before year end, the time may be insufficient if the right terminates at year end, but not if it extends into the next year for a reasonable time.

Nevertheless, it would seem to be safer to keep the money around until the withdrawal period lapses.

In addition to giving the beneficiary sufficient time to exercise withdrawal rights, the notice of the right must be adequate. In this regard, the notice clearly should be in writing and delivered to the beneficiary and, if applicable, the beneficiary’s guardian. Although the notice may be provided by the grantor, trust documents generally impose this obligation on the trustee. Where notice is given to a guardian, it should state that both the guardian and the minor have the right to withdraw for the specified period. Where the trustee is also the child’s guardian, notice would be meaningless and probably is not required. It is also probably not a good idea to rely on a one-time blanket notice in which the beneficiary is advised that each year henceforth he will have the specified withdrawal right, even if the beneficiary waives the right to future notices. In a situation where the trust required annual notices and the beneficiaries waived such right, the IRS ruled that there was no annual exclusion allowed for the gift of money to the trust to pay the premium. Even if a trust provides for a one-time notice, discretion would dictate against it.

The Lapse Problem

Much ado has been made of the so-called “lapsing” problem with respect to Crummey powers. Since a beneficiary has withdrawal power only for the period specified in the trust document, it is clear enough that the power will lapse if it is not exercised by the end of such period. A Crummey power is considered a “general power of appointment” over the property subject to the power since the holder of the power can appoint the property to himself. A release of a general power of appointment is considered a transfer of such property by the holder of the power to the trust. A lapse of a power is considered the same as a release of the power. It is as if the holder of the Crummey power exercised the right of withdrawal, took the money from the trust and transferred it back, irrevocably. If there are other beneficiaries of the trust, the part of the transfer to the trust allocable to them will be considered a gift to them by the holder of the power who allowed it to lapse. Accordingly, each holder who allows a withdrawal power to lapse will be deemed to have made a gift to the other beneficiaries. Furthermore, the part of the lapsed amount that is a gift to the other beneficiaries is a gift of a future interest not qualifying for the annual gift tax exclusion since the gift is not something to which they have immediate rights. However, the actual amount of the gift is generally quite small since a gift of a future interest must be discounted. Consequently, the gift tax implications of a lapsing power to withdraw are generally of no major concern. Utilization of the $600,000 exemption, if available, would thus be minimal.

Within limits, a special exception permits powers that lapse during lifetime to occur without the lapse resulting in a transfer to the trust with gift tax (and estate tax) implications. The exception permits a lapse during a taxable year not to be treated as a transfer to the trust to the extent that the property, which could have been appointed by exercise of such lapsed power, does not exceed in value, at the time of the lapse, the
greater of (i) $5,000, or (ii) 5% of the value, at the time of the lapse, of the assets out of which the exercise of the lapsed powers could have been satisfied. Since the latter amount would be applicable only to a funded trust (e.g., trust assets would have to exceed $100,000), the $5,000 figure is relevant to unfunded trusts. In other words, there would be a transfer to the trust as a result of the lapse only if and to the extent the right to withdraw that lapsed exceeded $5,000. Generally, insurance trusts with Crummey powers permit withdrawal up to the lesser of the value of the property transferred to the trust in the calendar year (i.e., the insurance premium amount) or $10,000 ($20,000 for a split gift). The obvious purpose of such a provision is to assure that the contribution to the trust by the grantor qualifies for the maximum annual exclusion. Accordingly, the lapping problem only exists if the premium required to be paid exceeds $5,000 times the number of beneficiaries with withdrawal rights. For example, if the contribution to the trust to pay premiums is $20,000, and there are four equal beneficiaries who let their withdrawal rights lapse, there would be no deemed gift by any beneficiary to the trust on the lapse of the power to withdraw since the lapse as to each beneficiary does not exceed $5,000. As to the grantor, the gift of the $20,000 would not be a taxable gift since the amount of the exclusion available is $40,000 ($10,000 x the number of beneficiaries with withdrawal rights). On the other hand, if there were only two beneficiaries who allowed their withdrawal rights to lapse, each would be deemed to have made a transfer to the trust in the amount of $5,000 (the right to withdraw of $10,000 less $5,000) and consequently a future interest gift to the other of $2,500 ($2,500 would be for the beneficiary’s own benefit). The grantor still would not have made a taxable gift since the exclusion available is $20,000 (two beneficiaries). Language in a trust limiting withdrawal to the extent of the greater of $5,000 or 5% of trust assets so as not to cause a gift are commonly referred to as “5 & 5” powers. However, such limitation would cause a taxable gift to the grantor (requiring use of his $600,000 exemption, if available) where the required premium exceeds the number of beneficiaries with withdrawal rights times $5,000.

Example: Grantor forms an irrevocable life insurance trust which takes out a policy on Grantor’s life. He is to transfer $25,000 each year into the trust, under which his two minor children (Gail, age 12, and Barbara, age 15) are equal beneficiaries, to pay the annual premium. Upon Grantor’s death, the life insurance proceeds are to be distributed to the children. However, no distribution is to be made to a child from the trust unless the child has reached age 30, and the trust will continue to this age. If a child predeceases the Grantor or dies before reaching the age she becomes entitled to her share of the life insurance proceeds, her share goes to the other. In order to get the benefit of two annual exclusions, so that there is no taxable gift to the extent of $20,000 (the extra $5,000 is offset by Grantor’s $600,000 exemption, if still available), Grantor gives the children Crummey powers under which each has the right to withdraw by the end of the year her share of the contribution to the trust up to an amount equal to the $10,000 annual exclusion. Adequate and timely notice of the right to withdraw is given. As is the rule, no withdrawal is made and the right to withdraw lapses. On lapse, each child will be deemed to have made a transfer to the trust of the lapsed amount which, in part, the other child will benefit from in futuro. However, the transfer to the trust will be only the excess of the lapsed amount over $5,000. So, rather than each child being deemed to have made a transfer of $10,000 to the trust, the amount of the transfer will be only $5,000 because of the “5 & 5” rule. The part of the transfer to the trust by one child that is a gift to the other will not qualify for the annual exclusion since it is considered a gift of a future interest in that the other child will only benefit from the policy upon the subsequent death of Grantor. More specifically, a transfer to the trust of $5,000 by each child would be deemed a gift to the other child of 1/2 of the $5,000 or $2,500 since each child has a continuing 1/2 interest. However, it would appear that since each child is making a gift to the other, the gifts would offset one another. This would be true except for the fact that the children are of different ages and thus the gift from one to the other will be different. The difference will be small, however, since the children are close in age and the gift would have to be discounted actuarially since it is a future interest. Based upon the above numbers, it appears that there would be a gift from the youngest child to the oldest in the amount of only $159. It may be stated, therefore, that permitting withdrawal in excess of the “5 & 5” amount is generally not of any major concern in this type of situation. Although the gift is small, a gift tax return is still required to be filed since the gift is not covered by the annual exclusion.

A Somewhat More Serious Concern

As discussed above, a lapse of a power is considered a transfer of the property subject to the power to the trust. Since a beneficiary who is deemed to have made a transfer of property by allowing the right to withdraw it to lapse has a continuing interest in the trust (i.e., a life estate), the property transferred is pulled back into the beneficiary’s estate under IRC § 2036. Consequently, lapsing powers are a more serious estate tax concern. Of special significance where there is a lapse of a power to withdraw in excess of the “5 & 5” de minimis amount, is the “cumulation” rule which causes lapsing powers to accumulate for estate tax purposes. Under this quite technical rule, if a right of withdrawal is not exercised in more than a single taxable year, the proportion of the property subject to the power, which is treated as a taxable disposition, will be determined separately for each year. The aggregate of the taxable dispositions that have lapsed each year is to be included in the gross estate of the person who did not exercise the right of withdrawal. Again, the amount treated as lapsed each year will only be the excess over the “5 & 5” amount. Further, if a person holds a power to withdraw at death, the property over which the power exists must be included in the gross estate. However, the “5 & 5” offset does not apply to the lapse of a power caused by the death of the holder.

The cumulation problem usually arises with respect to a lifetime income beneficiary of the trust who holds withdrawal powers (quite often a spouse) and relinquishes them in favor of remaindermen.

Example: Grantor establishes an irrevocable life insurance trust which provides that the income from the life insurance proceeds received on his death (after perhaps some contribution to pay estate taxes) is to be paid to Wife during her lifetime and, at her death, the trust corpus will be distributed equally to their (or perhaps his) three children. The annual premium on the policy (permanent insurance) is $45,000. In order to obtain four
annual exclusions so that $40,000 of the $45,000 premium does not require the payment of gift tax or use of Grantor’s lifetime credit/exemption. Wife and children are given Crummey withdrawal powers giving each of them the right to withdraw the lesser of their share of the contribution to the trust or $10,000.68 As is usual, the powers are not exercised and they lapse. Assuming that the de minimis amount under the “5 & 5” rule is $5,000, Wife is deemed each year to make a gift of the remainder value of $5,000 to the children because of the lapse. Assuming the Wife is age 60, the first year the remainder value gift is $1,419.69 Assuming that the cash surrender value of the policy in the first year is $25,000, the percentage of the gift to the trust assets is 5.7%. In the next year, when she is age 61, there is another lapse the gift value of which is $1,482. If the cash surrender value is $60,000 the next year, the percentage is 2.5%. No gift tax exclusions are available under the “future interest” rule. Wife dies before any further contributions are made to the trust, at which time the cash surrender value of the policy is $65,000. Under the cumulation rule, Wife’s gross estate would have to include $5,330 ($65,000 x 8.2%). This does not seem to be such a big deal. Taking it a step further, however, suppose Grantor dies with Wife surviving and the trust collects the face amount of the policy which we will assume is $1,000,000. Of course, no further premiums will be payable. Suppose Wife subsequently dies at which time the assets in the trust are worth $1,100,000. It would appear that the amount includible in her estate would be $90,200 (8.2% x $1,100,000). Obviously, if there were lapses in other years before Grantor died, the percentage would build up and that much more would be includible in her estate. The total percentage, however, cannot exceed 100%.70

The concept underlying the above result is that Wife has transferred property (the lapse amount) into a trust over which she has an income interest. Under IRC § 2036, gift transfers with a retained income interest are brought back into the estate at date of death value. However, any amount previously treated as a taxable gift (e.g., the $1,419 and $1,482) would not be counted as adjusted taxable gifts in computing the estate tax, and any gift tax paid would be allowed as a credit against the estate tax.71

Hanging Powers and Other Devices

Practitioners have devised several strategies to solve the lapse problem. One solution is the “hanging power.” Under this contrivance, the power in excess of the “5 & 5” amount ($5,000 in the above example) does not lapse. The power survives (hangs around) until future years in which, hopefully, it can be absorbed within the “5 & 5” limit. Thus, since there is no lapse, there is no current gift. For example, if it is expected that the policy will become fully paid up after a few years or that policy premiums will drop over time, then the hanging withdrawal powers could lapse at the rate of $5,000 per year (or 5% of trust assets if greater) when no further (or smaller) contributions will be necessary (i.e., when the policy is paid up). Another possibility is to have the hanging powers lapse at a point in time when the trust assets have built up to a point where 5% of trust assets would be in excess of the $10,000 current withdrawal right required to assure a gift tax exclusion for the current contribution. For example, if the cash surrender value builds up to $200,000, there could be a lapse of $10,000 (5% x $200,000) and thus no new hanging power would be created. Assuming that the next year the cash surrender value of the policy is $240,000, there could be a lapse of 5% or $12,000. This would absorb the $10,000 current premium allocable to the Wife, as in the above example, plus $2,000 of the hanging withdrawal rights.72

As time goes on, all of the hanging powers, it is hoped, will be absorbed. The problem is that if the Wife dies before all of her hanging powers are absorbed, she will be deemed to have a general power of appointment to that extent resulting in inclusion in her estate. If the Grantor dies first, there would appear to be no problem since the withdrawal right would then be 5% of the trust corpus ($1,000,000 in the above example). At this level, all hanging withdrawal rights would be absorbed either immediately, or at least should be by the next year.73

Another way of preventing a taxable gift and estate tax inclusion is to limit withdrawal rights to the “5 & 5” amount so there is no lapse. This is fine as long as the premium does not exceed $5,000 times the number of beneficiaries with withdrawal rights. Usually, this limitation would be satisfactory for term insurance where the premiums are smaller.

In certain cases, the lapsing problem can be avoided by giving the beneficiary a testamentary limited or general power of appointment over his trust share. This would render any lapse an incomplete gift.74 Although this would eliminate the gift tax problem, the property subject to the power of withdrawal would be included in the beneficiary’s estate.75 However, this is not a problem if it is expected that the beneficiary will not be subject to estate tax or will wind up with the life insurance proceeds anyway. Accordingly, this might work with respect to the children in the above example.

Finally, the trust could be initially funded with sufficient assets ($200,000) so that 5% would equal $10,000. As previously mentioned, most persons would be hesitant or financially incapable of donating this amount irrevocably and, besides, there would be a taxable gift to the extent in excess of the available gift tax exclusions.

Administrative Considerations

Once the trust is established, the first thing to do is to obtain a federal identification number for the trust which is essential to open a bank account and to purchase the policy. IRS instructions indicate that this could take four weeks. However, a fairly new procedure permits the number to be obtained by telephone immediately. After the identification number is acquired, a bank account should be established to accept the contribution to the trust for the premium. The premium should be paid out of this account by the trustee in order to insure that the annual exclusion is available (the trust contains the Crummey powers). In the event an existing policy is to be transferred to a trust (see discussion below), it will be necessary to get from the issuing company its Form(s) to change ownership and beneficiary designation (to the trust). After the forms are returned to the insurance company, one should follow up and get written confirmation from the
company that the necessary changes have been made. The trustee should also make sure the beneficiaries receive timely notice of their right to withdraw when a contribution is made to assure the insured gets exclusions for the contribution. Since the trust will usually have no income while the insured is alive, it will generally not be necessary to file fiduciary income tax returns. Of course, when the insured dies, the trustee has to collect the proceeds and administer the trust over its term.

The Three-Year Recovery Rule

The fundamental goal with respect to life insurance is to keep the proceeds, which are payable at death, out of the insured’s estate. Consequently, where the insured already owns a policy, there is a strong incentive to transfer the ownership either outright to an individual or to an irrevocable life insurance trust. In fact, those who are properly advised will do this. However, to prevent transfers in anticipation of death, the Internal Revenue Code mandates that the face amount of the policy be included in the decedent’s gross estate if he dies within three years of making the transfer. Consequently, unless the insured can peer into the future and determine that he will be alive in three years, it is better for the policy to be originally acquired by another or by a life insurance trust, rather than the insured gifting an existing policy. Sometimes, it may even pay to cash in an existing policy and have a new policy issued. However, this would be possible only if the insured is in sufficiently good health to be insurable and the new policy is not too costly. If the insured can’t get a new policy, the existing policy should nevertheless be transferred and one would then hope to live the requisite three years. If an existing policy with a cash value is transferred to a trust, the cash value will qualify for the annual exclusion to the extent of the number of trust beneficiaries holding Crummet powers. If there are insufficient exclusions to accommodate both the policy value and the premium, the policy should be transferred in a year where the premium has already been paid. The next year, the exclusions could cover the premium.

Conclusion

With estate taxes being as high as they are, there seems to be no good reason for an insured with estate tax exposure to own a life insurance policy. Furthermore, an insurance agent that issues a policy to an insured knowing that (or perhaps not inquiring whether) the insured might have a taxable estate, arguably, is negligent in so issuing the policy. In a recent situation, the author insisted that the agent cancel a new policy issued to the insured and reissue it to a newly established trust. As a general rule, a spouse should not be made the direct beneficiary of a life insurance policy if the spouse might be subject to estate tax, nor in this case should she own insurance on her own life. Care should be taken in drafting the trust so that lapsing powers do not result in unexpected estate and gift tax consequences. Once an insurance trust is established, the trustee should diligently attend to the administrative considerations. Obviously, the rules relative to life insurance trusts are quite technical. Nevertheless, it is quite easy (a “no-brainer,” if you will) to avoid the inclusion of life insurance proceeds in one’s estate. Simply, the insured should have no “incidents of ownership” in the policy at death.

ENDNOTES

1 Technically, the value of a permanent life insurance policy is its “interpolated terminal reserve value” plus the proportionate part of the gross premium last paid before the date of the decedent’s death which covers the period extending beyond such date. Treas. Reg. § 20-2031-8(a)(2) (as amended in 1974). This usually approximates the cash surrender value. This is usually the value for gift tax purposes provided the insured is reasonably healthy. All references herein to “Treas. Reg. §” are to the Treasury Department Regulations interpreting the Internal Revenue Code of 1986, as amended.

2 For purposes of this article, the masculine shall be deemed to include the feminine where applicable and vice versa. See, e.g., Section 1 of Title 1 of the United States Code regarding statutory construction which is applicable to the Internal Revenue Code. Also, see I.R.C. § 7701(m)(1).

3 I.R.C. § 101. All references herein to “I.R.C. §” are to the Internal Revenue Code of 1986, as amended. An exception is provided where the policy is transferred for a valuable consideration in which case the transferee can exclude only what he paid for the policy plus subsequent premiums. I.R.C. § 101(a)(2). The exclusion is reinstated in certain cases where the transfer is made to certain entities usually in the context of financing buy-out arrangements. I.R.C. § 101(a)(2)(A) and (B).

4 More accurately, the “Unified Transfer Tax” which is applicable to both lifetime gifts and transfers at death.

5 The “taxable base” under I.R.C. § 2031 is the amount of the taxable estate (gross estate less allowable deductions) plus adjusted taxable gifts made after 1976 other than gifts that might be pulled back into the decedent’s estate because of certain retained rights or powers, or when such rights or powers are released by the decedent within three years of the decedent’s death. I.R.C. §§ 2035(d), 2036, 2037, 2038. If there are no adjusted taxable gifts, the “taxable base” and the “taxable estate” are the same. For large estates exceeding $10,000,000 the benefit of the lower rates (i.e., below 55%) begins to be phased out by means of a surcharge and is fully phased out at $31,040,000. I.R.C. § 2021(e)(3).

6 A credit is allowed against the Federal estate tax for death taxes levied by a state or the District of Columbia but limited by a statutory formula. I.R.C. § 2051.

7 See Note 19, below, for further discussion.

8 I.R.C. §§ 6075(a), 6151(a). A lengthy extension of time to pay is permitted where the estate consists largely of a closely-held business including a farm. I.R.C. §§ 6161(a)(2), 6161.

9 I.R.C. §§ 2002, 6324(a)(2). Certain items may be included in the gross estate and subjected to the estate tax although they are not probate assets under the control of the executor (e.g., jointly held property, property subject to a general power of appointment held by the deceased at death and property previously transferred and pulled back into the estate under I.R.C. §§ 2035-2042).


11 I.R.C. § 2042.


The term “reversionary interest” includes a possibility that the policy or its proceeds may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of the reversionary interest is determined by using Treasury Department mortality tables. I.R.C. § 2042(2); Treas. Reg. § 20.2042-1(c)(3) (as amended in 1979).


See Note 5, supra.

1 In computing the taxable estate, an unlimited marital deduction is allowed for the value of property passing from a decedent to a surviving spouse if the property is included in the gross estate. The property must pass outright to the surviving spouse or may go into certain types of trusts in which the spouse or her estate has certain prescribed rights or powers. I.R.C. § 2056

2 In order for property given away during lifetime not to be included in the gross estate upon death, it must have been a non-taxable gift under the $10,000 annual per donee exclusion. I.R.C. § 2503(b).

3 The estate tax on a taxable estate (including adjusted taxable gifts, if any) of $600,000 would be $192,800, less the unified credit of $192,800 equals zero tax due. For those states that have an estate tax equal to or greater than the statutory credit allowed against the federal estate tax for local death taxes, the exemption equivalent amount is actually $642,425 rather than $600,000. The estate tax on a taxable estate of $642,425 is $208,497. Subtracting the unified credit of $192,800 and the statutory credit allowed for state death taxes on an estate of $642,425, which would be $15,967, no federal estate tax is due.

4 For expedience, the surviving spouse is referred to as “the” in this paper since statistics show that on average women significantly outlive men.

5 See Note 1, supra, Notes 32 and 41, below.

6 In New York, for example, a taxable estate exceeding $115,000 is subject to estate tax. N.Y. Estate Tax Law § 971(a) (McKinney 1996), for estates of decedents dying after June 9, 1994.

7 For example, see N.Y. Estates, Powers and Trusts Law § 2-1.6 (McKinney 1996).

8 Basic estate planning carves out a taxable estate for the decedent in the amount of $600,000, the unified credit exemption equivalent (commonly called the by-pass amount since it does not flow into the gross estate of the surviving spouse), with the remainder of the estate going to the surviving spouse in a manner that will qualify for the 100% marital deduction. The tax on the $600,000 will exactly equal the unified credit of $192,800 resulting in no estate tax. Under this type of plan, no estate tax (except possibly state estate or inheritance tax) will be payable on the death of the first to die. Rather, the estate tax consequences are deferred until the death of the survivor.

9 The author was involved in a situation where the proceeds of second-to-die insurance were made payable to a “supplementary needs” trust to provide for a manic-depressive daughter who was receiving SSI and Medicaid.

10 For purposes of this article, the singular shall be deemed to include the plural where applicable and vice versa. See, e.g., Section 1 of Title 1 of the United States Code regarding statutory construction and I.R.C. § 7701(m)(3).

11 See Note 5, supra.

12 See, e.g., N.Y. Insurance Law § 3205(c) (McKinney 1996).

13 Payment by the parent of the premiums on a life insurance policy owned by the child would be deemed a gift to the child in the amount of the premium paid in the taxable year.

14 Under I.R.C. § 2513, a donor and his spouse can treat a gift made by him at made one-half by him and one-half by his spouse, provided that both parties consent to such arrangement on a filed federal gift tax form. See Treas. Reg. § 25.2513-2 (as amended in 1983) concerning the mechanics of signifyng consent.

15 As discussed in more detail hereafter, only a gift of a “present interest,” as contrasted with a “future interest” qualifies for the $10,000 annual gift tax exclusion. I.R.C. § 2503(b).


17 Generally, a wife or husband may effectuate insurance upon the person of the other without the other’s approval. See, e.g., N.Y. Insurance Law § 3205(c)(1) (McKinney 1996).

18 Most states provide some type of exemption from creditors with respect to insurance policies. However, the laws vary considerably. See, e.g., N.Y. Insurance Law § 3212 (McKinney 1996).

19 Many people unknowingly name a spouse as a beneficiary of a life insurance policy with a minor child or children as secondary beneficiary. If the spouse predeceases and no other arrangements are made, through oversight or otherwise, it will be necessary to institute guardianship proceedings. Usually, the guardianship clerk of the court will wind up being co-guardian during minority. The minor children will wind up getting the full insurance proceeds at majority (age 18).

20 A “spendthrift” provision prevents a beneficiary from transferring his interest in the trust to satisfy the claims of creditors. The effect of a spendthrift provision depends upon state law.

21 If the trust is carefully drafted, it is possible for the surviving spouse to be the trustee. Discussion of this aspect is beyond the scope of this paper.

22 Since the amount transferred into the trust would be a future interest, the annual $10,000 exclusion will not be available to offset the funding unless the beneficiaries are given withdrawal rights for this amount as discussed hereafter. See Note 41, below.

23 I.R.C. § 677(a)(3).


25 An unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain) is a present interest in property. Treas. Reg. § 25.2503-3(b) (as amended in 1983).

26 See Note 31, supra.


28 397 F.2d 82 (9th Cir. 1968).
The Internal Revenue Service recently denied annual exclusions for a beneficiary with a vested remainder interest, beneficiaries with discretionary income interests and beneficiaries who had only “naked” Crummey powers. The IRS position was that substantively only a few beneficiaries were intended to be benefited, and that there was a pre-arranged understanding that certain beneficiaries would not exercise their withdrawal rights (Tech. Adv. Mem. 9628004).

Notice of 30 days was sanctioned in Priv. Ltr. Rul. 9030005.

See, Priv. Ltr. Ruls. 8008040, 7947066 and 782649. At the other extreme, the Internal Revenue Service has ruled that four or fewer days is insufficient (Tech. Adv. Mem. 9628004).

If necessary to obtain another exclusion, a Crummey power can be given to the wife of the grantor. In this regard, it should be noted that the contribution to the trust allocable to the wife does not qualify for the marital deduction since it is not a gift of a present interest. Thus, to create a present interest and another exclusion, the wife would have to be given a Crummey power.

Using IRS actuarial Table S and assuming an 8% “applicable federal rate” for the month of the lapse the remainder value is 28379. No exclusion is available since it is a gift of a future interest. See Rev. Rul. 85-88, 1985-2 C.B. 201.

Unfortunately, the Regulations are not clear on how the value of the future gift is to be determined in varying situations.

Although a trust is not initially funded with assets to generate income to pay premiums, it is possible that the cash surrender value might eventually build up to over $100,000, in which case the withdrawal right would exceed $5,000 (unless the withdrawal right excluded the policy itself).

48 See Note 60, supra.

49 The gift may be determined (bold your hate) using the following reasoning: Barbara (age 15) will get the future interest gift at age 20, or in 15 years. Gail (age 12) will get the future interest gift at age 30, or in 18 years. Using IRS Table b, and an “applicable federal rate” of 8%, the remainder value at 15 years to Barbara is 315242 x $2,700, or $878. The remainder value at 18 years to Gail is 250249 x $2,500, or $626. Also, Barbara would be assured of getting the remainder interest amount only if she reached age 30 and the same would be true for Gail. Using other IRS tables (80CNSMT - Mortality), the chances of Barbara living 15 years and reaching age 30 are 98.2% and the chances of Gail living 18 years and reaching age 30 are 98.1% (the older you are the greater your chances of reaching an older age). Thus, Gail’s gift to Barbara is $789 x 98.2%, or $773 and Barbara’s gift to Gail is $626 x 98.1%, or $614. In other words, the chances of both surviving to age 30 are very high. Offsetting the future gifts against one another, there is a net gift to Barbara of $159 ($773 - $614). This seems to make some sense since Barbara is older and will get the future interest sooner, and also being older there is somewhat of a greater chance that she will reach age 30. The foregoing computations are, of course, subject to debate.

49 Under this section, property that is transferred during lifetime in which the transferor retains a life estate is pulled back into the transferor’s estate at his death at the value at such time.


49 If necessary to obtain another exclusion, a Crummey power can be given to the wife of the grantor. In this regard, it should be noted that the contribution to the trust allocable to the wife does not qualify for the marital deduction since it is not a gift of a present interest. Thus, to create a present interest and another exclusion, the wife would have to be given a Crummey power.

49 Using IRS actuarial Table S and assuming an 8% “applicable federal rate” for the month of the lapse the remainder value is 28379. No exclusion is available since it is a gift of a future interest. See Rev. Rul. 85-88, 1985-2 C.B. 201.

50 See Note 66, supra.

51 I.R.C. § 2012.

52 Of course, this plan would not work for term insurance since there is, of course, no value build up.

53 It appears that a trust may even have a provision requiring consent of the trustee to exercise the hanging power (to assure that there is no actual withdrawal) provided the trustee did not create the power and does not have a substantial adverse interest in the property subject to the power which is adverse to the exercise of the power in favor of the possessor of the power. I.R.C. § 2514(b)(3)(B).

54 Treas. Reg. § 25.2511-2(b) and (c) (as amended in 1983).

55 I.R.C. §§ 2036 and 2038.

56 I.R.C. § 2035.