AQUILANCE

Crummey Powers, Crummey Letters, and Properly Funding Life Insurance Trusts

One of the most overlooked components of an integrated wealth management plan is properly filing gift tax returns and preparing annual Crummey notices. As we head into 2021 with the potential for higher taxes and the potential for a reduction in the lifetime gift and generation-skipping trust (GST) exemptions, sweating the details of the administration of Irrevocable Life Insurance Trusts (ILIT) has never been more important.

The Internal Revenue Service (IRS) continues to scrutinize ILIT contributions and their qualifications as annual exclusion gifts. We encourage advisors to educate and work with their clients and their administrative/legal teams to follow best practices when implementing and administering ILIT Crummey powers. Proper ILIT administration can make the difference between transferring property to an ILIT with only the use of recurring annual exclusion amounts versus losing lifetime GST tax exemptions entirely or, worse, paying additional gift taxes.

We suggest a helpful set of planning tools related to Crummey powers below. As a reminder, gifts to ILITs do not satisfy the present interest requirement, so most ILITs include Crummey powers that designate trust beneficiaries to withdraw all or part of the gift to the trust, up to the annual gift tax exclusion amount for each beneficiary, to a specific period of time. Should the Crummey powerholder not exercise their right within typically 30 days, their Crummey power lapses, and the transferred property remains in trust to be invested or used to pay insurance premiums.

Determine the ILIT's Annual Funding Amount

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Identify and Select the Appropriate Crummey Owner-Holders

- There is a delicate balance between adding more beneficiaries to the trust and providing powers to individuals that may not be appropriate. We would advise to exclude certain beneficiaries that are estranged from the family, have difficulty managing finances, or have creditor issues. Proper counsel can address these challenges.

Gift-Splitting Helps in Leveraging Exemptions

- The annual exclusion amount can be leveraged by making gifts by both spouses versus just one.

Provide Notice of Withdrawal Powers to Crummey Powerholders

- The IRS has taken the position that Crummey powerholders must receive notice of their withdrawal powers with regard to any annual exclusion gift to the trust and that a 30-day withdrawal period is sufficient. As a best practice, we encourage a withdrawal period of 30-60 days prior to a policy lapsing to provide enough opportunity and notice to the beneficiaries of the trust.

- During audits, the IRS has time and time again reviewed and challenged ILIT contributions and whether they qualify as annual exclusion gifts versus lifetime gift exemptions. Often, these administrative recommendations are not followed by the client and beneficiaries are not aware of their withdrawal rights. A way to protect yourself is by providing confirmatory Crummey notices to the beneficiaries should they not exercise their rights as a contingency.

What Gifts Are Not Subject to the Gift Tax?

The Educational Exclusion

- As a reminder, payments made directly to qualifying domestic or foreign learning institutions for the education of an individual qualify for the educational exclusion under Section 18 170(b)(1)(A)(ii) of the Internal Revenue Code (IRC).

- A few key rules apply:
  - — The payment must be made directly to the institution, not to the individual receiving the education.
  - — The payment must be for tuition only. Other expenses, such as supplies and room and board don't count.

The Medical Exclusion

- Payments that qualify for the medical exclusion include those made directly to a medical institution or care provider for the benefit of an individual. You can also make payment to a company that provides medical insurance to that person.

- Expenses that qualify are the same as those that are deductible for income tax purposes.

- For instance, you can pay for your grandchild's emergency appendectomy in the amount of $20,000 and also give your grandchild an additional $15,000 in the same year without incurring any federal gift tax.

Gifts to Political Organizations

- These are covered under Section 527(e)(1) of the IRC. Your gift must be used for the benefit of the organization and is unable to be passed along to anyone else.

- The IRS has taken the position that gifts to social welfare organizations do not qualify for the political organization exclusion under Section 2501(a)(4) of the IRC.

The Annual Exclusions

- An annual exclusion gift qualifies for the $15,000 per person per year exemption from federal gift taxes.

- The annual exclusion is indexed for inflation, so it can increase on an annual basis.

How Aquilance Can Help?

- Aquilance has been setting up Limited Power of Attorney accounts to fund Irrevocable Life Insurance Trusts (ILIT) for many years.

- Aquilance’s advanced book-keeping services and oversight can identify other gifts that are made throughout the year to children that are often missed. We work with advisors to educate their clients on what is considered to be a gift under the IRC.

- Aquilance will take the responsibility of preparing the Crummey letters to be sent to Crummey powerholders annually with 30-60 days’ notice and will provide a follow up confirmatory Crummey notice to the beneficiaries documenting that they have chosen to not withdraw funds.

- Aquilance will work closely with advisors and families to ensure that they have a proper repository of these letters and the documentation to support them in advance of future Estate and Gifts tax audits.