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TEN TREMONT STREET, SUITE 600 – BOSTON, MASSACHUSETTS 02108
Telephone: 617.720.6040 – Facsimile: 617.720.1919
www.bovelanga.com

Trusts & Estates Forum

Is There a MICRUM Trust in Your Client's Future?

By Alexander A. Bove, Jr. and Melissa Langa

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Parents or others wishing to make "tax-free" gifts to individuals under the age of majority have a limited number of options. They could make the gifts to a court-appointed guardian of the minor; they could make the gifts to a custodian under the Uniform Transfer to Minors Act ("UTMA"), Mass Gen. Laws Ch. 201A; they could establish a college savings account under I.R.C. §529; they could directly pay certain qualified education or medical expenses under Internal Revenue Code §2503(e); they could establish and make the gifts to a so-called irrevocable "minor's trust" under I.R.C. §2503(c); or they could make gifts to an irrevocable trust for the benefit of the minor (sometimes called a "Crummey" trust), described below.

In assessing which of these options is "best" in any given situation, we must look at the typical set of objectives, which range from the keep it simple order for relatively small gifts to the desire for creditor and "immaturity" protection lasting years after the individual has passed the age of majority. In fact, it is typically the latter of these objectives that the usual donor has in mind. That is to say, if over the years, gifts from the donor and others accumulate to a substantial amount, it is generally regarded as risky to hand the entire sum over to the beneficiary at age 18 (as in the case of a guardianship), or even at age 21 (as in the case of an UTMA or a standard minor's trust). So, are there better choices?

Many donors and advisors opt for the Crummey trust, an irrevocable trust for the benefit of one or more beneficiaries (who may or may not be minors). The term "Crummey" refers to the decision of a 1968 Ninth Circuit Court of Appeals case which held that if a minor beneficiary had the present unfettered right to withdraw his share of the contribution made to the trust, then the contribution would be considered a gift of a present interest to the beneficiary to the extent of his withdrawal power, and thus would qualify as a "tax free" gift up to the allowable I.R.C. §2503(b) present interest exclusion (presently $11,000 per donee per year, I.R.C. Rev. Proc. 2001-59). *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968). When a trust is drafted with a Crummey "withdrawal power", the provision usually states that if the beneficiary fails to withdraw his share of the contribution within 30 days of the notice, then the right of withdrawal expires and the gifted funds will remain in the trust to be administered according to its terms. In most cases, a Crummey trust will provide that funds not withdrawn remain in trust to provide benefits for the beneficiary at the discretion of the trustee until the beneficiary reaches a certain age, say 35.

When compared with the minor's trust, which *must* make the balance of funds available to the beneficiary upon reaching age 21, the Crummey trust at first glance appears to offer more protection against the beneficiary's immaturity or indiscretions. To help avoid this, many practitioners draft the minor's trust to provide only a brief period (a "window") within which the beneficiary has the power to withdraw the trust assets at 21, quite similar to a Crummey withdrawal power, and to the extent the beneficiary fails to exercise that power, the assets in the minor's trust would remain in the trust and the trust would continue to be administered for the benefit of the beneficiary, for the extended period chosen by the original settlor. See Treas. Reg. 25.2503-4(b)(2). For instance, Jeff establishes a minor's trust for the benefit of his son Jim, age 14. The trust provides that upon reaching age 21, Jim would have 30 days to withdraw the full balance of the trust's assets, but to the extent he does not do so, the trust would continue as a discretionary trust for Jim's benefit until age 40.

One of the advantages of the minor's trust over the Crummey trust is that through age 21 the minor's trust is a separate taxpayer, allowing for some favorable income tax planning. For example, basically, income is taxed to the trust if accumulated and to the child if distributed. No additional tax is later imposed when accumulated income is distributed to the child. Through this use of duel taxpayers, the trustee can often plan to eliminate or reduce the so-called "kiddie tax" which taxes a child under age 14 on her unearned income over approximately $1,500 at the parents' highest tax rate. I.R.C. §1(e). After the child attains age 21, however, the income is taxed directly to the child at the child's rate whether or not distributed. The Crummey trust, on the other hand, is treated as a "grantor trust" over an ever increasing portion of the trust from the beginning as the beneficiary fails to exercise withdrawal rights each year. In the eyes of the Internal Revenue Service the beneficiary is treated as if he withdrew the funds then immediately contributed them back to the trust; hence he is treated as the "grantor" of the trust for his own benefit as to that portion of the trust and is taxed on all trust income. I.R.C. §§ 677 and 678. One of the advantages of the Crummey trust over the minor's trust is that the donor(s) can continue to make annual tax free gifts to the trust long after the beneficiary has passed the age of 21. What many practitioners fail to realize is that it need not be a question of choosing between a Crummey trust and a minor's trust; the best of both of these trusts can easily be combined in what the authors call a "MICRUM" trust.

There is no reason that a minor's trust cannot be drafted to provide for the introduction of a Crummey withdrawal power to take effect upon the beneficiary's reaching the age of 21. This would give the donor and the minor all the benefits of the minor's trust through age 21, at which time the trust would effectively convert to a Crummey trust, and would continue until the time designated by the original settlor. As an added and significant advantage, MICRUM trust, could also provide a sort of "mini-estate plan" for the beneficiary, providing for his or her children in the event of the beneficiary's death, as well as alternate remaindermen or other dispositive arrangements, and in many cases, even future asset protection.

Furthermore, with the typical minor's trust or UTMA which requires pay out of the funds to the beneficiary at age 21, or the guardianship which requires a pay out at the ward's age of 18, the funds in these cases would be readily available to the minor's creditors as soon as they were in the beneficiary's hands. Contrast this with the MICRUM trust where the trust funds would not be available or reachable by the beneficiary's creditors until actually paid out to the beneficiary. This is because the power to withdraw, whether the 30 day lump sum power at 21 or the annual exclusion power thereafter, is a general power of appointment created by the original donor of the trust. The law in Massachusetts, as well as a majority of the other States, is well settled that, except in the event of bankruptcy, the creditors of the holder of a general power of appointment that was not created by the powerholder cannot force the powerholder to exercise his power nor can they reach the property subject to the power unless and until the powerholder exercises it. *Clapp v. Ingraham*, 126 Mass 200 (1879), and Restatement (Second) Property Section 13.2. Thus, so long as the assets remain in the trust, they can provide discretionary benefits to the beneficiary, remain protected from the beneficiary's creditors, and allow for annual tax free gifts by the donor.

Another benefit of the MICRUM trust is that it eliminates the need for annual withdrawal notices while the beneficiary is under age 21, since by statute the transfers into trust qualify for the present interest gift tax annual exclusion, I.R.C. §2503(c), while transfers to a traditional Crummey trust require the withdrawal notice to be sent to the beneficiary each year to so qualify. Further, the complications of "hanging powers" are also postponed until withdrawal rights begin, and such postponement necessarily accelerates the point in time in which the "hung" portion disappears. [Very briefly, a hanging power is one where the beneficiary's withdrawal right "hangs" over in part from year to year to the extent that the particular year gifts for that beneficiary exceed the greater of 5% of the trust or $5,000.]

Regarding the generation-skipping transfer ("GST") tax, if the MICRUM is established by a grandparent for the benefit of a grandchild, and the grandparent transfers $11,000 to the trust as the first gift of the year to the grandchild/beneficiary, then such transfers, regardless of the grandchild's age, qualify for the GST annual exclusion thus eliminating the need to file annual gift tax returns to allocate GST exemption to the gift. I.R.C. §2642(c)(2)(A)-(B) and Treas. Reg. §26.2642-1(c)(3).

As to the recent expansion of the GST deemed allocation provisions by the introduction of new I.R.C. §2632(c) enacted as a part of the Economic Growth and Tax Relief Reconciliation Act of 2001, while a transfer to a MICRUM trust for the benefit of a grandchild should be classified as a "direct skip", and therefore not covered by the expanded deemed allocation rules for "indirect skips", a cautious practitioner might file a gift tax return following the first gift into trust and affirmatively "opt out" of the deemed allocation rules. I.R.C. §2632(c)(5).

One slight drawback of the MICRUM trust may apply to a client who wishes to establish a trust for the benefit of several children. A MICRUM trust, due to I.R.C. §2503(c), must have only one beneficiary, as opposed to a Crummey trust which may have multiple beneficiaries, all with withdrawal powers. The cost of multiple MICRUM trusts may well influence a frugal client to chose the Crummey alternative.

Another potential drawback to the MICRUM trust applies to the selection of the trustee. A trustee's discretion to distribute trust property under the minor's trust may not be substantially restricted. Treas. Reg. 25.2503-4(b)(1). Thus, a trustee's discretion may not be limited by an "ascertainable standard", i.e., distributions only for the "health, education, maintenance, and support" of a beneficiary. Thus, neither the donor or the donor's spouse may be the trustee of the MICRUM for the benefit of the child because the unfettered discretion may cause estate tax inclusion under I.R.C. §§2036 and 2038 if the child died before age 21. and while a parent was trustee. However, the donor and/or the donor's spouse could be designated within the trust instrument as an "investment advisor", with an independent trustee.

Thus, the MICRUM trust expands the list of traditional estate planning techniques available to a client who wishes to pass property to a minor beneficiary.