

B. Funding Third-Party Supplemental Special Needs Trusts

1. Income Tax

a. Inter Vivos

(i) Grantor Trust – No income tax consequences to the settlor or to the trustee. See IRC §§ 671-679.

(ii) Non-Grantor Trust – No income tax consequences to the settlor or to the trustee. See IRC §§ 102 and 1015.

b. Testamentary – No special income tax rules or consequences when funding a testamentary third-party supplemental needs trust. Same as funding any other type of testamentary trust.

2. Gift Tax

a. Incomplete Gift – No gift tax issues. Gifts to a trust are incomplete for gift tax purposes if the trust is revocable or if the trust is irrevocable and the settlor retains certain powers over the trust and/or its assets (such as a limited/special power of appointment). See IRC § 2511 and Treas. Regs. §§ 25.2511-2(b) and (c). But, see § 2511(c) for transfers to a trust after December 31, 2009.

b. Complete Gift

(i) No “Crummey” Withdrawal Right – Completed gifts for gift tax purposes to an irrevocable trust are gifts of a future interest to the trust beneficiary or beneficiaries. As a result, gifts to an irrevocable trust are not eligible for the annual exclusion. See IRC § 2503(b). As a result, the donor will be required to prepare and file a gift tax return (IRS Form 709). Note: The current annual exclusion amount is \$15,000.

(ii) “Crummey” Withdrawal Right – The existence of a “Crummey” withdrawal right transforms a completed gift to an irrevocable trust from a gift of a future interest to a gift of a present interest, which, in turn, makes the annual exclusion available to the donor. See IRC § 2503(b) and *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968). As a result, the donor may be able to avoid filing a gift tax return. Filing a gift tax return may still be advisable to start the statute of limitations if the donor is likely to have a taxable estate.

(iii) Limitation of “Crummey” Withdrawal Right – The “Crummey” withdrawal right should not be given to the primary beneficiary of the third-party supplemental needs trust if Medicaid eligibility is an issue because of the Medicaid asset limitation and asset transfer rules. However, “Crummey” withdrawal rights can be given to parties who have legitimate interests in the trust as either income or remainder beneficiaries. See *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991) (but, be careful of “naked Crummey” withdrawal rights; see IRS Technical Advice Memorandum 9628004). It is ideal to structure