

“Crummey” withdrawal rights so that they are limited to the “five by five” power (i.e., the “Crummey withdrawal right should be limited to the greater of \$5,000 or 5% of the trust assets) or designed as “hanging powers.” See IRC §§ 2514(e) and 2041(b)(2). Otherwise, certain gift tax and generation-skipping transfer tax consequences will result as to the “Crummey” withdrawal beneficiary or beneficiaries. Careful attention should be given to all applicable tax laws when using “Crummey” withdrawal rights, including income tax (grantor trust rules). The settlor can be given the power to vary the identity of who receives the “Crummey” withdrawal right on an annual basis without causing inclusion of trust assets in the settlor’s gross estate for estate tax purposes. See PLRs 9834004 and 9030005.

C. Administration of Third-Party Supplemental Needs Trusts

1. Income Tax

a. Inter Vivos

(i) Grantor Trust – All income, losses, deductions and credits taxed back to the settlor as if trust does not exist. Trustee has some income tax compliance responsibilities. See I.C.1.a.(ii) above.

(ii) Non-Grantor Trust – Traditional fiduciary income tax rules for trusts apply, including simple versus complex trust structure, distributable net income (“DNI”), trust principal and income allocation issues for tax and non-tax considerations, no deduction for expenses attributable to tax-exempt income (such as municipal bonds), and fiduciary investment fees subject to 2% of the trust’s adjusted gross income or “AGI” (see the *Knight v. Commissioner*, U.S. ____, 128 S. Ct. (2008) and IRS Notices 2008-116 and 2008-32). See I.C.1.b. above. It is worth noting that an irrevocable third-party supplemental needs trust may qualify as a “**Qualified Disability Trust**” (which provides an increased personal exemption of \$4,150 for 2019 [same as an individual] when compared to \$100 for complex trust or \$300 for a simple trust). See IRC § 642(b)(2)(C).

b. Qualified Disability Trusts – Qualified Disability Trusts have higher personal exemptions (\$4,150 for 2019) than simple trusts (\$300) and complex trusts (\$100). See IRC § 642(b)(2)(C). The income tax brackets for Qualified Disability Trusts are the same as the income tax brackets for simple and complex trusts (i.e., very compressed). A third-party supplemental needs trust will qualify as a Qualified Disability Trust if it meets the following requirements:

(i) Irrevocable – The third-party supplemental needs trust must be irrevocable and cannot be revocable because grantor trust status will be realized. See IRC § 676. However, as noted above, an irrevocable third-party supplemental needs trust can be either inter vivos or testamentary.

(ii) Non-Grantor Trust – The trust must be subject to the general rules of fiduciary income taxation and the trustee must be required to prepare and file fiduciary income tax returns (e.g., IRS Form 1041 along with supporting forms and schedules