Valuation of Minors' Income Interests in 2503 (b)

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I. Introduction

Section 2503(b) of the Internal Revenue Code of 1954 provides for an annual gift tax exclusion of $3,000.1 If the exclusion is to be allowed, there must be a completed gift.2 The donor must be divested of all title, dominion and control over the property transferred to a donee capable of accepting a gift or to someone acting for the donee as a trustee or agent capable of accepting it.3

Primary responsibility for payment of the tax rests upon the donor,4 but an exclusion is allowed for each donee.5 If the gift is transferred in trust, the trust beneficiary, rather than the trust itself, is considered the donee of the gift.6 Unlike the specific $30,000 exemption,7 which is an exhaustible life-time exemption, the donee exclusion can be taken in each year that a completed gift is made.8

1 Int. Rev. Code of 1954 §2503 provides:

   (b) Exclusions from Gifts—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1955 and subsequent calendar years, the first $3,000 of such gifts to such person shall not for the purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

When the gift tax was enacted in the Revenue Act of 1932, the maximum exclusion was $5,000. That figure was reduced to $4,000 in the Revenue Act of 1939 and to $3,000 in the Revenue Act of 1942 where it has remained to the present time; Mertens, Law of Federal Gift and Estate Taxation, §38.01, at 464, footnote 9 (1959). Gift splitting provisions introduced in the Revenue Act of 1948, would allow an exclusion of up to $6,000 for a gift of a present interest from a married couple to a donee during a calendar year, §2513 of the 1954 Code.

2 Treas. Reg. §25.2511-2(b) (1958) provides:

   As to any property, or part thereof or interest therein, of which the donor has so parted with the dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.


4 Int. Rev. Code of 1954 §2502(d). However, under §6324(b) the donee becomes personally liable if the tax is not paid by the donor when due; also see, Richard H. Turner, 49 T.C. No. 38 (1968).


6 Helvering v. Hutchings, 312 U.S. 393 (1941), conclusively decided that, for gift tax purposes, the donee of a gift in trust is the trust beneficiary rather than the trust itself. The case settled a dispute that had existed among the lower courts.

7 Int. Rev. Code of 1954 §2521.

II. PRESENT INTEREST IS REQUIRED

The interest conveyed must be a present interest if it is to qualify for the gift tax exclusion. The term present interest has been construed to mean, a right to use, possession and enjoyment commencing with the completion of the gift. Where a transfer is made in trust, legal title and possession of the trust corpus will normally pass to the trustee. An income interest may be regarded as a present interest even though the interest in corpus is limited to take effect in the future or revert to the grantor at some future date. However, although the donee may have a present interest in both corpus and income, only one exclusion per donee will be allowed. Of course, if the trust is not drafted properly the donee will not receive a present interest in either and no exclusion will be given.

III. VALUATION OF INCOME INTERESTS

Since section 2503(b) applies to the first $3,000 of a gift it is axiomatic that the present interest transferred must have a determinable

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1 INT. REV. CODE OF 1954 §2503(b). The requirement of a present interest was established in §504 of the Revenue Act of 1932 and retained in §1003 of the 1939 Code and §2503 of the 1954 Code.
2 Commissioner v. Disston, 325 U.S. 442 (1944); Fondren v. Commissioner, 324 U.S. 18 (1944); Suplee v. Smith, 242 F.2d 855 (3rd Cir. 1957).
3 BOGERT, TRUSTS AND TRUSTEES §181 (2d ed. 1960).
4 In Herman's Estate v. Commissioner, 235 F.2d 440, 443 (5th Cir. 1956), the court stated:
Either or both [corpus or income] may be a present interest to which the exclusion would be applicable and either or both may be a future interest with respect to which the exclusion would be denied. The fact that one of these may be regarded as a future interest does not of itself prevent the other from being a present interest.
5 Albright v. United States, 308 F.2d 739 (5th Cir. 1962); Fisher v. Commissioner, 132 F.2d 383 (9th Cir. 1942).
6 In REV. RUL. 58-242, 1958-1 CUM. BULL. 251, income was payable to the donors daughter and the corpus was to revert to the donor after 10 years and 6 months.
7 MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION §38.24 (1959).
8 Note 10 supra.
9 In Sensenbrenner v. Commissioner, 134 F.2d 883 (7th Cir. 1943), income was to be paid quarterly or oftener, to or for the use of the beneficiary; see also, Albright v. United States, 308 F.2d 739 (5th Cir. 1962); Fisher v. Commissioner, 132 F.2d 383 (9th Cir. 1942).
10 In Commissioner v. Disston, 325 U.S. 442, 449 (1944), the Court stated:
In the absence of some indication from the face of the trust or surrounding circumstances that a steady flow of some ascertainable portion of income to the minor would be required, there is no basis for a conclusion that there is a gift of anything other than for the future.
In Margaret A. C. Riter, the taxpayers' wife was to receive the income of two trusts during the minority of the couple's two children, but the trustee could invade the corpus of either trust at any time for the benefit of the children. The commissioner refused to allow the exclusion on the basis that the power to invade could be used to destroy the trusts. In affirming the commissioner's ruling the Tax Court stated: “Since we are unable to compute any value for the present interest of the wife, we can not hold that the respondent erred in refusing to allow an exclusion based on her right to receive the income.”

Since there may be a situation where it is unrealistic to assign a zero value to a present interest as in the Riter case, a court may allow the exclusion if some minimum value can be ascertained. In William Harry Kniep, the taxpayer created a trust for the benefit of six persons, the income of which was to be paid annually until each respective beneficiary reached age sixty, at which time each was to receive his proportionate share of the trust corpus. The trustee was given the power to invade the corpus for the benefit of the income beneficiaries in the event of an emergency, but not in excess of one thousand dollars per beneficiary per year. The Tax Court held that the right to income constituted present interests, which qualified for the exclusion, only to the extent to which such interests were not exhaustible by the exercise of the power to invade. Thus, the exclusion was applied to the present value of each income interest assuming an annual invasion of corpus of one thousand dollars per beneficiary per year.

In valuing a transfer for gift tax purposes, the value of the property on the date of the transfer is considered to be the amount of the gift. It is imperative, therefore, that any interests transferred have some

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19 MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION, §38.08 (1959). For examples of present interests held incapable of valuation, see Fischer v. Commissioner, 288 F.2d 574 (3rd Cir. 1961); Funkhouser's Trusts v. Commissioner, 275 F.2d 245 (8th Cir. 1960); Commissioner v. Lowden, 131 F.2d 127 (7th Cir. 1942); Van Den Wymelenberg v. United States, 272 F. Supp. 571 (E.D. Wis. 1967); Sylvia H. Evans, 17 T.C. 206 (1951), aff'd., 198 F.2d 435 (3rd Cir. 1952). The valuation problem appears to be one of the primary reasons for restricting the exclusion to a present interest. In United States v. Pelzer, 312 U.S. 399, 403 (1941), a trust was created for eight minor children and for possible afterborn children. Income was to be accumulated and paid out at the end of the trust period, which was ten years. In holding the income interests to be future interests under a predecessor of 2503(b), the Supreme Court examined the legislative history of the section and learned: “The denial of the exemption in the case of gifts of future interests is dictated by the apprehended difficulty, in many instances of determining the number of eventual donees and the value of their respective gifts.” (emphasis added)

20 3 T.C. 301 (1944).

21 Id. at 303.

22 9 T.C. 943 (1947), aff'd., 172 F.2d 755 (8th Cir. 1949). Although the statutory basis for the decision has been changed (see last sentence of 2503(b), note 1 supra) it would appear that the requirement of at least some ascertainable minimum value is still a valid criteria in qualifying an income interest for the exclusion.

reasonably determinable value at that time.\(^2\) While there is no doubt that an unqualified right to regular income payments can constitute a present interest in such income,\(^2\) for example, a gift conveying an income interest for a term of years, the Regulations state three requirements for valuing such an interest.\(^2\) First, the time span over which the income interest is to be distributed must be calculable. If a minor beneficiary were to receive the corpus when he attained his majority, the term of the trust would be the difference between his present age and twenty-one, the age at which the income interest would terminate. Of course, a well-drafted trust would provide for a gift over in the event of the beneficiary’s death before the corpus was to be paid. Assuming that the beneficiary’s life expectancy exceeds the age at which corpus is to be paid to him, the proper method of computing the term is as is mentioned in this paragraph and not based upon the beneficiary’s life expectancy.\(^2\) Second, the total value of the income-producing property must be determinable by a reasonable approximation. If the principal were marketable securities, the market value at the date of the gift might be used. Third, the actuarial factor which is provided in the appropriate table of the Regulations must be determined. The tables are not simply mortality tables, but combine an assumed rate of return (3.5%\(^2\)) with life expectancy or a stated term of years.\(^2\) By using the proper figure from the appropriate table, one simple computation reveals the present value of the gift in question, which is the amount of the gift for tax purposes. For purposes of illustration, assume that the corpus of a trust is $20,000, that the beneficiary is fifteen years of age and is entitled to receive income of the trust until he is age twenty-five. Assuming the beneficiary’s life expectancy is greater than age twenty-five, the income interest to be valued is for a term of years. Table II is the applicable table. The income interest would be valued by multiplying the value of the property ($20,000) by .291081, the appropriate figure from column three of Table II. Such a computation equals $5,821.62. The taxpayer would be obligated to pay tax on $2,821.62, the present value of the gift less the $3,000 exclusion.\(^3\) As can readily be seen, simple interest on

\(^{21}\) Note 22 supra.
\(^{23}\) Note 17, supra.
\(^{24}\) TReAs. REG. §25.2512 (1958).
\(^{25}\) Fischer v. Commissioner, 132 F.2d 383, 386 (9th Cir. 1942) ; Leonard Rosen, 48 T.C. 834 (1967) (Taxpayer used the wrong table).
\(^{26}\) TReAs. REG. §25.2512-5(f) (1958) (Table I applies to a life interest, Table II applies to an interest for a term certain).
\(^{27}\) Ibid. Compare, DUNHAM, Valuing Life Estates and Remainders, 107 TRUSTS AND ESTATES 13 (1968), where the author argues that specific experience tables should be used instead of the patent assumptions of the Regulations.
\(^{28}\) Note 28 supra ; Leonard Rosen, 48 T.C. 834 (1967), rev’d —— F.2d —— (4th Cir. 1968) ; Carl E. Weller, 38 T.C. 790 (1962).
\(^{29}\) The computation assumes that the gift does not qualify under the gift splitting provisions applicable to husband and wife under §2513, and that the donor’s $30,000 lifetime exemption under §2521 has been exhausted.
$20,000 for ten years would yield income of $7,000 not $5,821.62. However, the table computes the present value of the income to be received, which is the amount of the gift for tax purposes.\textsuperscript{32}

IV. DISCRETIONARY POWERS AFFECTING VALUATION

When a fiduciary is given a discretionary power regarding a trust, a determination must be made of how that power affects the rights of the trust beneficiary.\textsuperscript{33} Valuation problems may arise if the exercise of such a power would permit possible impairment or destruction of a present interest subsequent to the creation of the trust.\textsuperscript{34}

A. EXTENT OF DISCRETION

Even though a trustee is granted a discretionary power he is normally subject to various fiduciary duties and is subject to court control for violation of those duties.\textsuperscript{35} The extent of the trustee's discretion may have an important bearing on his duties, because the amount of court control varies with the discretion given.\textsuperscript{36}

The extent of discretion is commonly classified as "mere" or "unqualified" discretion as distinguished from "absolute" or "uncontrolled" discretion.\textsuperscript{37} The latter half of the classification is a misnomer and tends to cause confusion because, if construed literally, it would absolve the trustee of all fiduciary duties regarding the exercise of the power and thereby make the trust void.\textsuperscript{38} The true nature of the extent of discretion question may be summed up as follows:

It may be argued that the only difference in the attitude of the courts with regard to mere and absolute discretionary powers is one of degree, in that they are more easily persuaded to find an improper use of an absolute or uncontrolled power.\textsuperscript{39} (emphasis added)

The above inconsistency is mentioned only to alert the reader to the construction usually given such terms as "absolute" or "uncontrolled" discretion, because they are so commonly used.

The Restatement of Trusts, recognizes the distinction between a mere grant of discretion, and a grant of "absolute" or "uncontrolled" discretion.\textsuperscript{40} For convenience of discussion, the former will be referred to by this writer as simple discretion and the latter as extended discretion, even though the Restatement does not clearly designate them as such.\textsuperscript{41}

\textsuperscript{32} Note 23 supra.
\textsuperscript{34} MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION, §38.07 at 484 (1959).
\textsuperscript{35} Restatement (Second), Trusts §187 (1959).
\textsuperscript{36} Id., Comment i and j.
\textsuperscript{37} Bogert, Trusts and Trustees §560, at 103 (2d ed. 1960).
\textsuperscript{38} Id. at 120.
\textsuperscript{39} Id. at 125.
\textsuperscript{40} Note 36, supra.
\textsuperscript{41} This terminology is used in HALBACH, Problems of Discretion in Discretionary Trusts, 61 Col. L. Rev. 1425 (1961), and 50 Marq. L. Rev. 539 (1967).
If the fiduciary is empowered to exercise simple discretion, he is under a duty to the beneficiary to exercise that degree of care and skill that a man of ordinary prudence would exercise in dealing with his own property. Under a grant of an extended power of discretion, the duty of acting within the standard of reasonableness is relaxed. The fiduciary must act in a state of mind in which it was contemplated by the settlor that he would act. Under such a grant of discretion, "the trustee will not be permitted to act dishonestly, or from some motive other than the accomplishment of the purposes of the trust, or ordinarily to act arbitrarily without an exercise of his judgement.

Wisconsin apparently adheres to the Restatement classification, although two recent cases that dealt with the issue have not expressly stated the position of the court. In a case of extended discretion the court has held the trustee to the duty of acting in good faith. The good faith standard does not require the duty to exercise reasonable judgment, but only that the fiduciary not act dishonestly, arbitrarily or in contravention of the express or implied purposes of the trust.

When a fiduciary is given a discretionary power regarding the administration of a trust, the extent of his discretion is determined by state law. This in turn may control the application or non-application of the gift tax exclusion, as will be discussed in some of the following subsections dealing with specific discretionary powers.

Although this writer has discovered no consistent differentiation in cases involving extended discretion as opposed to cases where the trustee has simple discretion; most courts and legal scholars continue to consider the two concepts as viable legal principles, and for that reason are dealt with in this article only to aid the reader in a more meaningful analysis of the tax cases to be discussed. The extent of the trustee's discretion will be mentioned in various tax cases only as a point of information, and distinguished only in specific cases where a valid comparison can be made. It would seem that part of the reason why courts do not systematically differentiate between the effects of the two measures

42 Restatement (Second), Trusts §174 (1959).
43 Restatement (Second), Trusts §187, Comment j (1959).
44 Ibid.
45 Ibid.
46 In re Koos Estate, 269 Wis. 478, 69 N.W.2d 598 (1955); Estate of Teasdale, 261 Wis. 248, 52 N.W.2d 366 (1952); Estate of Wells, 156 Wis. 294, 144 N.W. 174 (1914).
47 Estate of Schiebe, 30 Wis.2d 116, 140 N.W.2d 196 (1966), noted in 50 Marq. L. Rev. 559 (1967); Will of Clarenbach, 23 Wis.2d 71, 126 N.W. 614 (1964), noted in 48 Marq. L. Rev. 262 (1964) and in 1965 Wis. L. Rev. 391.
48 Note 46, supra. For a discussion of the current Wisconsin position, see 50 Marq. L. Rev. 559 (1967).
49 In re Koos Estate, 269 Wis. 478, 69 N.W.2d 598 (1955).
of discretion is that in many instances the outcome of a case would be the same under either.

B. POWER TO INVADE CORPUS

Under the 1939 Code, the power of a trustee to invade corpus in favor of anyone, including an income beneficiary, might result in failure of a gift of an income interest to qualify for the gift tax exclusion. In Funkhouser's Trusts v. Commissioner, the donor established seventeen trusts for his five children and twelve grandchildren. The trust beneficiaries had an unqualified right to trust income, from the time of creation of the trusts until twenty-one years after the death of the last survivor of the grantor's children or until death of the last surviving descendant of the grantor. The trustees were given extended discretion to invade the corpus of the trust for the benefit of an income beneficiary or for any member of his or her immediate family. The court conceded the fact that the unqualified right of beneficiaries to receive income was a present interest but, the gift tax exclusions were denied because the income interests were not susceptible of valuation. The court reasoned:

The right of the income beneficiaries to receive income was dependent upon the existence and amount of a corpus from which the income was to be derived. There was no certainty as to duration or amount. The corpus of any trust could have been reduced at any time, in any amount (with corresponding reduction of income productivity). . . .

The 1954 Code has eliminated this problem of valuing an income interest, even though the fiduciary has the power to invade corpus, as long as the power of invasion may be exercised only for the benefit of the income beneficiary. The Regulations provide the following example.:

Example (4). Under the terms of a trust the net income is to be paid to F for life with the remainder payable to G on F's death. The trustee has the uncontrolled power to pay over the corpus to F at any time. Although F's present right to the income may be terminated, no other person has the right to such income interest. Accordingly, the power in the trustee is disregarded in determining the value of F's present interest. The power would not be disregarded to the extent that the trustee during F's life could distribute the corpus to persons other than F.

53 INT. REV. CODE OF 1939 §1003.
54 Funkhouser's Trusts v. Commissioner, 275 F.2d 245 (4th Cir. 1960) (The case dealt with a trust created under the 1939 Code which gave the trustee extended discretion); Evans v. Commissioner, 198 F.2d 435 (3rd Cir. 1952).
55 275 F.2d 245 (4th Cir. 1960).
56 Id. at 247.
57 §2503(b) (last sentence) "Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person."
58 TREAS. REG. §25.2503-3(c) (1958); see also, Estate of Brigid Angela Casey, 25 T.C. 707, 718 (1956), decided under the 1939 Code, but recognized that a different result would have followed if the 1954 Code were applicable; MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION, §38.22 (1959).
Although the *Funkhouser* case is not authority for a trust created under the 1954 Code, involving a power to invade corpus in favor of an income beneficiary, it appears that the basis for the decision would still be applicable to a trust where the fiduciary had power to invade in favor of someone else. For this reason a draftsman should limit the trustee's power to invade corpus so it is exercisable only in favor of the income beneficiary whose income interests is to be valued. In a trust created for the benefit of several income beneficiaries, it would appear that the invasion of corpus would have to be on a pro rata basis. Otherwise corpus could be paid to one beneficiary and thereby completely destroy the interests of the others.

C. Power to Terminate the Trust

Under the 1939 Code the effect of a power to terminate the trust had substantially the same effect on an income interest as a power to invade corpus.⁵⁹ If the trustee had no traditionally worded power to invade corpus, but had discretion to terminate the trust the amount of corpus would remain constant but, the uncertainty of the duration of the trust would make the income interest incapable of valuation. An excellent case in point is *La Fortune v. Commissioner*,⁶⁰ in which several donors created twenty-nine trusts for their minor children, the income of which was to be paid to the respective beneficiaries or their guardians until the beneficiaries attained the age of twenty-one. A gift over was provided for in the event of a donee's death before attaining majority. Thirteen trusts established in 1951-2 contained a clause giving the fiduciary power to terminate the trust,⁶¹ while sixteen trusts created in 1953-4, contained no such clause. The court allowed the exclusion claimed under the 1953-4 trusts, but denied the donor's contention that the 1951-2 trusts also qualified for the exclusion. The court reasoned:

The value of a present right to income given in a trust is calculated by multiplying the expected annual return by the probable period over which it will be paid. In the case of the 1951-2 gifts, the probable period over which the income will be paid is uncertain because the trustee has the discretionary right of termination.⁶²

This writer has discovered no case authority on this specific point but, it would appear that under the 1954 Code, if upon termination of the trust, the corpus was payable only to the income beneficiary, the trust would qualify for the exclusion.⁶³ In essence, neither the power to term-

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⁵⁹ *La Fortune v. Commissioner*, 263 F.2d 186 (10th Cir. 1958).


⁶¹ *Ibid.* at 189, "Trustee shall have the right and authority, in his or her sole discretion, to terminate this trust at any time he or she deems it for the best interests of the beneficiary to do so. . . ."


⁶³ Note 58 supra, example 4 seems to be either a very broad power to invade or a power to terminate.
inate nor the power to invade would have a substantial effect on the valuation problem if corpus could be paid only to the income beneficiary of the trust.

D. POWER TO SELL AND REINVEST CORPUS

An income interest of a gift in trust, otherwise incapable of valuation because the corpus consists of non-income producing property may qualify for the gift tax exclusion if the fiduciary has the power to dispose of such property and invest in property that will generate income on a regular basis. Of course, the burden is on the taxpayer to demonstrate that the trustees are expected to exercise this power for the benefit of the beneficiaries and that they will probably do so. It appears that a donor of a gift of income who is interested in an annual exclusion would be inviting a challenge from the Internal Revenue Service on the valuation aspect, if he transferred non-income producing property and relied only on the trustee's power to sell and reinvest to justify his claim to the gift tax exclusion. This is so because of the requirement that the interest donated must have a reasonably ascertainable value on the date the gift is completed. However, such an argument may prove to be valuable at the litigation stage.

If the original corpus of a trust is income producing in nature, it would appear that a grant to a fiduciary of a power to sell and reinvest may be desirable in the event of changed circumstances in the future. The argument would have to be asserted that such power would be exercised only to maintain principal capable of generating income. In this connection, it appears that a grant of simple; rather than extended, discretion might give the donor a stronger argument in asserting that the power would only be exercised in the desired manner because the grant of simple discretion required the fiduciary to use reasonable judgement in the administration of the trust.

E. POWER TO ACCUMULATE INCOME

A power to accumulate may render an income interest incapable of valuation, because there must be a reasonably ascertainable flow of income to the trust beneficiary if the gift is to qualify for the gift tax exclusion. The Regulations provide the following example of the dangers involved if the trustee is given the power to accumulate income:

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65 Id. at 847.
66 Note 23 supra.
67 Prejean v. Commissioner, 354 F.2d 995 (5th Cir. 1966); Fischer v. Commissioner, 288 F.2d 574 (3rd Cir. 1961); Camiel Thorrez, 31 T.C. 655 (1959), aff'd. per curiam, 272 F.2d 945 (6th Cir. 1959); see generally, MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION §38.32 (1959).
68 Commissioner v. Disston, 325 U.S. 442 (1944) and Fondren v. Commissioner, 324 U.S. 18 (1944), held that the trustee's discretion to accumulate income made gifts in trust future interests and, therefore, they did not qualify for the exclusion.
Example (1). Under the terms of a trust created by A, the
trustee is directed to pay the net income to B, so long as B shall
live. The trustee is authorized during any period he deems advis-
able to add such income to the trust corpus. Since B's right to re-
ceive the income payments is subject to the trustee's discretion,
it is not a present interest and no exclusion is allowable with
respect to the transfer in trust.\(^9\)

In Camiel Thorrez,\(^70\) the donor conveyed a ten percent interest in a
partnership in trust to each of his four children for the benefit of his
ten minor grandchildren. The trust stated that income was to be accumu-
lated until each beneficiary reached the age of twenty-one, unless the
trustee deemed it advisable to use part of the trust income for the benefit
of a donee before that time, or if a beneficiary should need money for
support or education and be unable to provide it. The Tax Court held
the income interests incapable of valuation and denied the exclusion.
The court reasoned:

There is always the question of how much, if any, of the income
or principal of each trust can actually be applied in any year for
the permitted purpose of the support or education of a beneficiary.
The existence of a discretionary power, upon the occurrence of a
specified contingency, to make payments from the trust estate to
a beneficiary or his legal guardian gives no clue to the amounts
that will be needed for the stated purpose or to the requirements
for support and education that were foreseeable at the time the
gifts were made.\(^71\)

The danger of granting a fiduciary the power to accumulate income
can readily be seen if the donor is interested in utilizing the donee exclud-
sion, but such a gift in trust may still qualify for the exclusion if it can
successfully be argued that the trustee was required to use the trust
property as if held by him as a guardian for the donee,\(^72\) or the trust
otherwise provided for a guardian over the property.\(^73\) In United States
v. Baker,\(^74\) the trust provided that the net income and principal of the
trust were to be used for the support, education or benefit of a beneficiary
in such amounts and manner and at such times as shall be in accordance
with the needs and best interests of the beneficiary, as if the trustee were
holding the property as a guardian.\(^75\) The court allowed the exclusion
because the trustee's broad powers and fiduciary obligations made the
transfers equivalent to outright gifts. In view of the alternatives avail-

\(^{69}\) Treas. Reg. §25.2503-3(c) (1958).
\(^{70}\) 31 T.C. 655 (1959) aff'd. per curiam, 272 F.2d 945 (6th Cir. 1959).
\(^{71}\) Id. at 666.
\(^{72}\) United States v. Baker, 236 F.2d 317 (4th Cir. 1956); Rev. Rul. 59-78, 1959-1
\(^{73}\) Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951); contra, Stifel v.
Commissioner, 197 F.2d 107 (2nd Cir. 1954); the Stifel case is distinguished at,
\(^{74}\) Note 72 supra.
\(^{75}\) Id. at 319.
able a guardianship appears to be an undesirable means of qualifying a gift for the annual exclusion, but the argument might prove to be valuable during litigation.

F. DISCRETION TO ALLOCATE BETWEEN INCOME AND CORPUS

A fiduciary may be granted a discretionary power to allocate income of a trust between income and principal. The effect that such a power has on the problem of valuation of an income interest may depend in large measure upon the extent of discretion bestowed upon the trustee, and the apparent intent of the settlor. In Frances Carroll Brown, the donor transferred corporate stock valued at $175,000 in trust, the income of which was payable to four named beneficiaries for life with the remainder to charity. The trustees were granted extended discretion to allocate receipts of the trust between income and principal. The court held that the grant of absolute discretion to the trustees did not bar a court of equity from controlling an abuse of discretion. The court stated:

To hold that the trustee has the power under an absolute discretion clause to cut off all the rights of the life tenant would confer upon the trustee the power to destroy one of the primary purposes of the trust, i.e., the purpose to benefit the life tenant. An attempted destruction of one of the purposes of the trust would constitute an abuse of discretion which the courts would control.

The court went on to decide that the gifts of income constituted present interests that were capable of valuation. The court held:

A careful reading of the whole indenture of trust indicates that the intention of the settlor was to give the income beneficiaries a substantial present interest and nowhere does it appear that she intended to favor remaindermen to their income detriment. It does not appear that the trustee's discretion-

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76 Restatement (Second), Trusts §233 (1959).
77 Id. comment p.
78 Restatement (Second), Trusts §187, comment j (1959).
79 30 T.C. 831 (1958). The principal issue was whether or not the gift of income was a present or a future interest, but the court decided the valuation problem presented the same issues.
80 Id. at 832, the trust provides:

(f) Dividends, interest, rents, and other similar payments, other than liquidating dividends, received in cash by the Trustees shall normally be dealt with as income, whether ordinary or extraordinary, and whether or not in the nature of dividends on mining stocks or other assets of a wasting nature, ... and whether or not the securities to which they relate shall have been purchased at a premium and irrespective of the character of the assets or account out of which they are paid or the time when they shall have accrued or accumulated or shall have been earned, declared or made payable, but the Trustees are authorized, in their absolute discretion, to allocate the whole or any part of any such payment to principal, if they shall deem such action advisable for any reason.
[Emphasis added]

The issue of the corresponding rights and duties of the trustees and beneficiaries was decided under Maryland law.
81 Id. at 836.
any powers were granted for any other purpose than to facilitate administration of the trust.\textsuperscript{82}

In \textit{Van Den Wymelenberg v. United States},\textsuperscript{83} the donors established a trust for their twelve minor grandchildren. The trust corpus consisted of real estate worth $132,500, but subject to a mortgage of $82,500. Income of the trust was to be distributed annually, but the corpus was not to be paid to a beneficiary until he reached the age of twenty-one. The trustee was given, what appeared to be, extended discretion in dealing with the trust property, which included the power to sell and reinvest corpus and to allocate trust receipts and expenditures between principal and income.\textsuperscript{84} Without stating what language of the trust was most heavily relied upon in making its decision the court held that the income interests did not qualify for the exclusion because they were incapable of valuation. The court reasoned:

The trustee not only can apportion between principal and income, but can also alter the trust asset. By use of the latter prerogative, the trustee could revise the asset holdings so that only a minimal amount of income was derived for the present; on the other hand, the trustee could change the corpus to a wasting asset which would produce a great amount of income while consuming the principal. None of these decisions on the part of the trustee would necessarily be improper or a violation of her fiduciary responsibilities.\textsuperscript{85}

\textsuperscript{82} \textit{Id.} at 837.

\textsuperscript{83} 272 F. Supp. 571 (E.D. Wis. 1967), \textit{aff'd --- F.2d ---} (7th Cir. 1968).

\textsuperscript{84} The case does not contain any statement of the trust language relied upon by the court. The following are excerpts from the trust instrument:

... [T]he Trustee may perform every act in the management of the trust estate which individuals may perform in the management of like property owned by them free of any trust and may exercise every power with respect to each item of property in the trust estate, real and personal, which individual owners of like property can exercise, ...

* * * *

J. To determine whether any money or other property coming into the hands of the Trustee is part of the principal of the trust fund or income therefrom, and to apportion between principal and income any loss or expenditures which, in Trustee's opinion, should be apportioned, as the Trustee may deem just and equitable, ... and any such determination as between corpus and income so made by said Trustees in \textit{good faith} shall be conclusive and binding upon the beneficiaries and any other persons who may be interested in said trust fund.

* * * *

7. Every action taken by said Trustee pursuant to the powers conferred hereby, or any decision made by said Trustee in the exercise of the discretion herein given to the Trustee, \textit{shall be conclusive} and binding upon the beneficiaries and upon all persons concerned therein or affected thereby.

* * * *

9. The Trustee shall not at any time be held liable for mistake of law or fact, or of both law and fact, or errors of judgment nor for any loss coming to said trust fund, or to a beneficiary thereunder or to any person except through \textit{actual fraud} or \textit{wilful misconduct} on the part of the Trustee. [Emphasis added]

\textsuperscript{85} Note 83 \textit{supra}, at 574.
Although the court did not expressly mention the extent of the fiduciary's discretion and her corresponding duties, nor the effect that extended discretion would have on the issue of valuation, one might contend that the last sentence of the above quote implies recognition of the Restatement position that a grant of extended discretion to a fiduciary only requires that he act in good faith. The argument could be made that a fiduciary could deal with the trust property as the court suggested, while acting in good faith, but would be abusing discretion if he acted in such a manner while held to the standard of exercising reasonable judgement. Therefore, the court probably viewed the trustee as holding an extended grant of discretion.\textsuperscript{66}

The \textit{Van Den Wymelenberg} and \textit{Brown} cases may be distinguished on the basis of the purpose for which the trusts were established.\textsuperscript{67} In the \textit{Brown} case the beneficiaries were to receive income for life and the remainder was payable to charity. Obviously the primary purpose of the trust was to provide a continuous flow of income to the life beneficiaries. In the \textit{Van Den Wymelenberg} case the beneficiaries were to receive income until their majority with the remainder to be distributed to them at that time. There was no express or implied preference to provide regular income rather than to retain as much of the property as possible until corpus was to be distributed.

V. Probabilities

The courts are often compelled to look beyond the area of discretion to the question of probabilities in assessing the ramifications of a discretionary power upon a trust beneficiary's interests. There is an obvious overlapping in considering the question of discretion and probabilities, but the latter has a broader thrust than discretion and, therefore, is often resorted to in an effort to determine whether or not an income interest is capable of valuation. The reason for this examination is predicated

\textsuperscript{66} Because the settlor in the \textit{Van Den Wymelenberg} case expressly granted the trustee discretion to determine what trust receipts constituted income and principal, it would seem appropriate that the application of the \textit{Wisconsin Uniform Principal and Income Act}, Wis. Stat. §231.40(2) (1965), was not made an issue in the case. Perhaps by implication this case will serve to dissipate some of the confusion caused by \textit{Will of Clarenbach}, 23 Wis.2d 71, 126 N.W.2d 614 (1964). The Clarenbach case is severely criticized in, \textit{Note}, 1965 Wis. L. Rev. 391.

\textsuperscript{67} \textit{Boerst, Trusts and Trustees} §560 at 119 (2d ed. 1960), provides:

\begin{quote}
Notwithstanding the fact that a literal interpretation of these grants of \textit{absolute} and \textit{uncontrolled} discretionary powers would seem to sanction any action taken by the trustee thereunder and leave the courts powerless to intervene, such a construction has not been given to them. The settlor has created a trust to accomplish certain objectives. When he gives his trustee great freedom of action in administration of the trust, he surely must intend the qualification that the trustee shall act with some regard to the \textit{purposes} of the trust, and not make decisions which frustrate the accomplishment of the settlor's intent; and also that he shall employ his discretion deliberately and with some thought and not recklessly or capriciously, and furthermore in a spirit of good faith and honesty. [Emphasis added]
\end{quote}
upon the necessity of assigning some reasonably ascertainable value to a
gift in trust on the date the gift is completed,\textsuperscript{88} if it is to qualify for the
annual donee exclusion.

The leading case on this subject is \textit{Hugh Mck. Jones},\textsuperscript{9} in which the
court held that valuation of income interests would be allowed if: (1) a
power of encroachment was limited by an ascertainable standard, and
(2) the possibility of encroachment being made in accordance with such
standard was so remote as to be negligible.\textsuperscript{90} Jones created separate
irrevocable trusts for his four adult children under which they were to
receive income for life, with remainder to the respective beneficiary's
issue per stirpes. The donor and a corporate trust company were design-
nated co-trustees. The trustees were given simple discretionary power
to invade the corpus of the trusts for the use and benefit of the benefici-
aries for their proper maintenance, education and support, in the manner
in which they were accustomed, or for any other purpose that the trustee
might deem reasonable under the circumstances. The court declared that
invasion of corpus for the respective beneficiary's proper maintenance,
education, support etc. . . . constituted an ascertainable standard. Fur-
thermore, the court found that because of the financial position of the
respective adult beneficiaries, the possibility of encroachment of the
principal which would defeat the flow of income was so remote as to be
negligible.

The grantor also created an irrevocable trust for four minor children
of his deceased son. The trust provided that during the minority of the
beneficiaries the co-trustees could use and apply so much of the net in-
come and principal of the respective shares of each minor as deemed
necessary for their proper education, maintenance and support. Upon
reaching majority, the beneficiaries were to receive the entire income
from their respective shares until the principal was completely distributed
at various ages. In applying the above mentioned criteria to the trusts
for the minor beneficiaries, the court found that the interests were not
capable of valuation. The trust provisions established an ascertainable
standard for limiting the power to invade but, the possibility of exercis-
ing that power within the standard was by no means remote. Such an
invasion could deplete the corpus and completely destroy the income
interests. Although the precise basis for the \textit{Jones} decision (the effect
on valuation of the trustee's power to invade corpus in favor of an in-
come beneficiary) has been overruled by a statute,\textsuperscript{91} the principle enunci-
ated in that case is still viable and the decision has been cited with ap-

\textsuperscript{88} Note 23 supra.

\textsuperscript{89} 29 T.C. 8200 (1957) (The case is decided under the 1939 Code, when the power
to invade in favor of anyone including the income beneficiary might make the
income in interest incapable of valuation).

\textsuperscript{90} \textit{Id.} at 211.

\textsuperscript{91} \S 2503 (b).
proval in subsequent cases involving various discretionary powers of a fiduciary.92

The possibility of action on the part of the trustee to alter the trust corpus in accordance with an ascertainable standard must be so remote as to be negligible. In Jolley v. United States,93 the donor established a trust for his three adult children who were named trustees as well as primary beneficiaries. Income was to be paid to the beneficiaries for ten years in monthly or quarterly installments. The trustees were given extended discretion to use all or part of the corpus of the trust for the support, maintenance, education, comfort and benefit of any issue of a primary beneficiary. After citing the Jones case with approval, the court held that the income interests were capable of valuation. The opinion states: “In the Jolley, Sr. Trust proceedings there has been in evidence substantial evidence that the use of corpus for the support, education and maintenance of the beneficiaries would be extremely remote.”94

There must be a standard limiting the trustees power of encroachment. In the Van Den Wymelenberg case,95 the court cited the Jones case and stated the rule to be applied almost verbatim from that decision.96 Although the trustee in Van Den Wymelenberg did not have direct power to invade the corpus of the trust for the benefit of the grandchildren she had “powers which could significantly effect the income available to the beneficiaries.”97 The precise reasons for the court’s decision are not expressly stated in the opinion but, it might be argued that the probability question was the courts real basis for denying the exclusion. Clearly, there was no ascertainable standard to guide the trustee in determining when to alter the trust corpus or in determining how to allocate receipts and expenditures between income and corpus. Because Judge Gordon cited the Jones case it is indicative of concern over the absence of a standard, but whether he would have gone on to examine the second part of the probabilities test is doubtful in view the fact the trustee’s discretionary powers could be exercised to the benefit or the detriment of the trust beneficiary.

While Jones indicates that the standard can be fairly broad, and Jolley indicates that extended discretion is not necessarily fatal, Wymelenberg suggests that extended discretion without a standard may make an income interest incapable of valuation.

94 Id. at 324; (The court did not state the evidence relied upon.
95 Note 83 supra.
96 Id. at 324.
97 Ibid.
The case of *J. J. Newlin*,98 represents an anomaly to the rule of the *Jones* case. The settlor created a trust of corporate stock for the benefit of his three adult children. Income of the trust was to be paid to the beneficiaries in equal shares as requested. The trust could be terminated at any time with the consent of all the beneficiaries. Corpus would then be distributed on a pro rata basis. Although the trust specified no *standard* to which the beneficiaries must conform in terminating the trust the court held that the income interests were capable of valuation. The court reasoned that because the power to terminate the trust rested in the income beneficiaries, rather than a third party, the possibility of termination was too remote as to be negligible.

It is interesting to note that if this trust had been created under the 1954 Code the problem would not have arisen.99

VI. TYPES OF PROPERTY FREQUENTLY CONVEYED IN TRUST

A. CORPORATE STOCK

If corpus of a trust was composed of public corporation stock, the market value of the stock on the date of the gift would probably be used to determine the value of such corpus. If the term of the trust or the donee's life expectancy were known, the value of an income interest could easily be computed, provided the taxpayer could demonstrate that the stock comprising corpus was capable of producing income. In *Leonard Rosen*,100 a recent Tax Court decision, two major stockholders in a public corporation created an irrevocable trust for each of their minor children by conveying shares of the corporate stock to third party trustees. Each beneficiary had an unqualified right to net income of his or her trust no less frequently than annually. The corpus of each trust was to be distributed to the respective beneficiaries in installments beginning at age twenty-five. Provision was made for gifts over if a child died prior to a distribution date. The trustees were given power to sell the stock and reinvest the proceeds.

The petitioners made no claim regarding the corpus of the trusts, but asserted that the income interests qualified for the annual gift tax exclusion. The government did not challenge the exclusions on the ground that the gifts failed to qualify as present interests, but took the position that the so-called income interests were not susceptible of valuation. The corporation, formed in 1957, had never paid dividends either before or after the formation of the trusts in 1961. The petitioners argued that their past record should not be controlling and that, because dividends might be paid in the future the exclusions should be allowed. The Tax Court held that the income interests created in the children were not sufficiently

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98 31 T.C. 451 (1958). The case dealt with the 1939 Code, under which the power to invade corpus or terminate the trust in favor of anyone including the income beneficiary might cause the exclusion to be denied.

99 Note 57 supra.

100 48 T.C. 834 (1967).
susceptible of reasonable valuation to constitute interests qualifying for the $3,000 exclusion. The decision was based on two grounds. First, because of an aggressive expansion policy of the corporation, the petitioners were unable to demonstrate the probability of dividend payments in a regular pattern. Second, the evidence of surrounding circumstances justified the inference that the trustees intended to, and were expected to retain the corpus of the trust despite the broad power of sale and reinvestment.\footnote{Id. at 847. The evidence of surrounding circumstances revealed that the trustees were personal friends of the donors, and well acquainted with the latter's business. The court seems to lay great weight on the donors apparent intent to have the trustees remain in possession of the stock and the probability that the fiduciaries would comply with that desire.}

Of course, the petitioners' argument for allowance of the exclusion under the second method was based on the premise that reinvestment would be in income producing property.

Restriction of transfer\footnote{James v. Commissioner, 148 F.2d 236 (2nd Cir. 1945) (The case involved the depression effect on value of stock, subject to an agreement restricting its transfer.)} and difficulty of valuing principal,\footnote{Snyder's Estate v. United States, 285 F.2d 857 (4th Cir. 1961).} may make a gift of close corporation stock undesirable if the donor seeks to take advantage of annual exclusion. The variables involved in valuing the stock itself may leave the gift open to contest by the Internal Revenue Service. Earnings, dividends and dividend paying capacity, and book value are significant factors to be weighed in valuation of close corporation stock.\footnote{Central Trust Company v. United States, 305 F.2d 393 (Ct. Cl. 1962).}

If a reasonable value can be ascribed to the stock, the problems of valuing an income interest appear to be similar to those encountered when the trust corpus is composed of stock of a public corporation. In Elsie Mck. Morgan,\footnote{42 T.C. 1080 (1964), aff'd. per curiam, 353 F.2d 209 (4th Cir. 1965), cert. den., 384 U.S. 918 (1966).} a case involving the dividend payment record of a close corporation, the Tax Court refused to allow the exclusion where dividends had been paid in only two of the eleven years immediately preceding creation of the trusts in question. The court disregarded the fact that dividends were paid after the exclusions had been challenged because the issue was whether or not the income interest was capable of valuation at the date of the gift.

B. LIFE INSURANCE

Another common subject matter of a gift that might cause valuation problems is life insurance. A gift in trust of a life insurance policy, assuming it has a cash surrender value, creates two kinds of interests in the donee; proceeds rights and policy rights.\footnote{Commissioner v. Chase Manhattan Bank, 25 T.C. 617 (1955), aff'd., 259 F.2d 231 (5th Cir. 1958), cert. den., 359 U.S. 913 (1959).} Proceeds rights are the benefits payable to the beneficiary upon the death of the insured. Because...
these rights are contingent upon death of the insured they are classified as future interests.\textsuperscript{107}

Policy rights include the whole bundle of incidents of ownership of property in a policy—all rights except the right to proceed. This bundle includes all the economic benefits of the insurance, the cash surrender value, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign the policy or revoke an assignment, the power to pledge the policy for a loan, the power to obtain from the insurer a loan against the surrender value of the policy.\textsuperscript{108}

The cash value at the date of the gift is an interest that would qualify for the exclusion if the trustee has the power to surrender it for the beneficiary's benefit.\textsuperscript{109}

The Regulations take the rather anomalous position that an outright gift of an insurance policy is a present interest, even in the proceeds rights,\textsuperscript{110} if there are no restrictions of any kind in the policy or in the instrument of transfer.\textsuperscript{111} The rationale of this scheme of taxation was explained in \textit{Commissioner v. Chase Manhattan Bank};\textsuperscript{112} where the court stated, "Gift and estate taxation of insurance is not based upon receipt of proceeds. It is based on the transfer of property rights. All gift and estate taxes are based on the transfer of effective control over property rights not the donees or heirs receipt of property."\textsuperscript{113} Where an assignment of an insurance policy is held to be a gift of a present interest, subsequent premium payments on such policy are likewise held to be gifts of present interests.\textsuperscript{114} The fact that a policy does not have a cash surrender value at the time of transfer is immaterial. The test is whether the interests of the donee in the policy are in some manner restricted.\textsuperscript{115} Accordingly, restrictions in the insurance policy itself may prevent the transfer from qualifying for the exclusion.\textsuperscript{116}

\textsuperscript{107} Treas. REG. §25.2503-3(c), example 2 (1958).
\textsuperscript{109} Sidney R. Baer, 12 Tax Ct. Memo. 914 (1943); Treas. REG. §25.2503-3(a) (1958), provides:

The term [future interest] has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But, a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

\textsuperscript{112} Note 106 supra.
\textsuperscript{113} 259 F.2d 231, 255 (5th Cir. 1958).
\textsuperscript{114} Note 107 supra:

Example (6). L pays premiums on a policy of insurance on his life, all of the incidents of ownership (including the right to surrender the policy) are vested in M. The payment of premiums by L constitutes a gift of a present interest in property.

\textsuperscript{115} Note 111 supra.
\textsuperscript{116} Joe J. Perkins, 1 T.C. 982 (1943).
Although the value of the gift may not vary significantly if both proceeds and policy rights are transferred as opposed to a transfer of only policy rights the basis for valuation is different. Replacement cost is the usual criteria in the first instance,\(^\text{117}\) while cash value is usually the standard in the latter.

C. Bonds

The exception in the regulations regarding life insurance also applies to bonds.\(^\text{118}\) Even if the bonds were non-interest bearing they would qualify for the exclusion.\(^\text{119}\) In *Commissioner v. Kempner,*\(^\text{120}\) the donor made gifts to minors of non-interest bearing notes payable in three and four years. The gifts were held to qualify for the exclusion under the 1939 Code, because the trustees were to distribute proceeds to the donees as soon as possible. The provision placed no real restrictions over the proceeds of the property.

Although this writer has discovered no direct authority on this specific point it would seem that a gift of Series E United States Savings Bonds would qualify for the exclusion even though they pay no interest until maturity.\(^\text{121}\) It would seem that the income interest from Series H Bonds would qualify in any event because a table of checks issued clearly indicates that an ascertainable flow of income can be predicted. The interest is payable semiannually by check drawn to the order of the registered owner or co-owner.\(^\text{122}\)

VII. Alternatives to a 2503(b) Trust

A. Outright Gifts to Minors

If the subject matter of a gift has an ascertainable value at the date of transfer, an outright gift to a minor donee\(^\text{123}\) or his guardian,\(^\text{124}\) would avoid any further valuation problem. However, certain non-tax reasons may make an outright transfer to the minor undesirable. Brokers, issuers, purchasers and transfer agents would be forced to deal with the minor at their peril, as he could disaffirm any transaction.\(^\text{125}\) The reluctance of these people to deal with a minor donee may make it almost impossible for him to convert the property to cash during his minority, the time when funds may be needed most for support, education or a possible emergency. In such an instance, the added expense of appointing a guardian may be necessary.


\(^{118}\) Note 110 supra.

\(^{119}\) Ibid.

\(^{120}\) 126 F.2d 853 (5th Cir. 1942).

\(^{121}\) 31 C.F.R. §316.2(e) (1967).

\(^{122}\) 31 C.F.R. §332.2(e) (1967).


\(^{125}\) Ury, Gifts to Minors, 43 Taxes 697 (1965).
B. 2503(c) Trusts

A trust for a minor that would not otherwise qualify for the donee exclusion might still be eligible if it is drafted according to the provisions of section 2503(c). In essence, section 2503(c) provides that a gift to a minor qualifies for the exclusion if the property and the income therefrom may be expended for the benefit of the donee before his attaining twenty-one years of age. Property not so expended must be conveyed to the donee when he attains his majority. If the donee should die before attaining the age of twenty-one, the unexpended income and corpus, if any, must be payable to his estate or as he may appoint under a general power of appointment.126

In Commissioner v. Herr,127 the settlor established a trust for each of four grandchildren, under which the trustee was to pay over the income to the respective beneficiaries until age thirty and then to pay over principal. During minority of the beneficiaries, the trustee was to retain the income payable to any minor, reinvesting it and paying over so much of the income as he deemed necessary for the maintenance and support of the donee. All unexpended sums of accumulated income were to be paid to the minor at his majority. The court allowed the exclusion on the basis that 2503(c) applied to an interest in income even though the donee had no present right to corpus. The basis for the court's decision was that the word property, as used in the statute, is not synonymous with corpus. The point was reiterated in Rollman v. United States,128 where the court followed the Herr case and reasoned:

Since Section 2503 applies to all forms of gifts, it covers a transfer of property in which the property itself is income, viz., an assignment of rents. Income rights may be productive of income, e.g., interest on an overdue installment, interest on income after receipt, or an increment upon the investment of income received.129

An income interest may qualify for the donee exclusion under 2503(c) although it would obviously be barred under 2503(b).130

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126 INT. REV. CODE OF 1954 §2503(c), provides:

(c) TRANSFER FOR THE BENEFIT OF A MINOR—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and income therefrom—

(1) may be expended by or for the benefit of, the donee before attaining the age of 21 years, and

(2) will to the extent not so expended—

(a) pass to the donee on his attaining the age of 21 years, and

(b) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

127 303 F.2d 780 (3rd Cir. 1962); followed in, Rollman v. United States, 342 F.2d 62 (Ct. Cl. 1965); Carl E. Weller, 38 T.C. 790 (1962).

128 342 F.2d 62 (Ct. Cl. 1965).

129 Id. at 67.

130 Jacob Konner, 35 T.C. 727 (1961).
example, a trustee may accumulate income under a 2503(c) trust and the donee's interest therein will still qualify for the exclusion. In Carl E. Weller, the Tax Court stated, "Income during the term of the trust can be accumulated but is required to be paid over to the beneficiary as he or she attains majority."

The method of valuing an income interest for a term of years is exactly the same for a 2503(c) trust as for a 2503(b) trust. However, under a 2503(b) trust the donee must demonstrate that the corpus is capable of generating income at a minimum rate, and that income will be distributed to the donee on a regular basis. It would appear that under a 2503(c) trust the donor would qualify the gift of income for the exclusion merely by showing that the income is capable of generating income at the specified rate because the exclusion may be taken even though the trustee has discretion to accumulate income.

At first blush, a trust drafted within the provisions of 2503(c) appears to have many advantages to a 2503(b) trust but, caution must be observed at the drafting stage or the transfer may not qualify for the exclusion under either provision. If an attempt is made to draft a trust under 2503(c), there can be no substantial restrictions either upon the exercise of the trustee's discretion to determine the amounts of income or property to be expended for the benefit of a minor, or upon the purpose for which the expenditure is to be made. The question of what is or is not a substantial restriction on the trustee's exercise of discretion has been a recurring problem in litigation involving 2503(c) trusts to date. In Commissioner v. Thebaut, the donor conveyed property in trust, income of which was payable to minor beneficiaries annually or in the trustee's discretion. Any unexpended income and corpus were to be distributed when the beneficiary attained the age of twenty-one. The trustee, however, was not given the power to expend corpus for the beneficiaries' benefit during minority. The restriction on corpus was found to be substantial. In a recent Revenue Ruling, the commissioner declared that a trust which provided the trustee with discretion to expend property or income for a beneficiary's support, care, education, comfort and welfare during his minority was not a substantial restriction on the trustees exercise of discretion, because the purposes

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132 Id.
133 Id. at 809.
135 Discussed in an earlier section of this article.
136 Commissioner v. Thebaut, 361 F.2d 428 (5th Cir. 1965) (The exclusion was denied regarding corpus).
137 TREAS. REG. §25.2503-4(b) (1) (1958).
138 Duncan v. United States, 368 F.2d 98 (5th Cir. 1966); Commissioner v. Thebaut, 361 F.2d 428 (5th Cir. 1965); Ross v. United States, 348 F.2d 577 (5th Cir. 1965).
139 Note 136 supra.
140 REV. RUL. 67-270.
of such expenditures had no objective limitation. Furthermore, such terms when read as a whole tend to approximate the scope of the term "benefit" as used in section 2503(c).141

C. WISCONSIN GIFTS TO MINORS ACT

In Wisconsin, even though a gift to a minor is not income producing, it can qualify for the gift tax exclusion by the use of the Wisconsin Gifts to Minors Act,142 which covers gifts of money, securities, life insurance143 and annuities.144 A gift made under its provisions qualifies for the donee exclusion145 because legal title vests in the beneficiary146 and is similar in effect to an outright gift.147 Thus the entire currently ascertainable value of an interest qualifies for the exclusion.148 The Gifts to Minors Act is deemed most useful where the corpus of the trust is relatively small and the donor is not reluctant to allow the donee to receive unexpended corpus and income at the age of twenty-one.149

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141 Note 126 supra.
143 Id. at §319.61(5). A question has been raised regarding the availability of the annual exclusion for life insurance, Peersol, Gifts to Minors, How Effectively has the Uniform Act Functioned?, 25 N.Y.U. Inst. Fed. Tax. 1099 (1967).
148 47 Marq. L. Rev. 1, 9 (1963) The act cannot be used to convey only an income interest.
149 Note, 69 Harv. L. Rev. 1476 (1956).