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Taxation -- Gifts in Trust for Minors -- Annual Exclusions

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public interest. That there may also be a corresponding public interest, perhaps even greater, in holding a municipality liable for the negligence of its employees is merely to emphasize some of the undesirable consequences of the traditional "municipal tort immunity idea." There is good argument for the complete abolition of the "municipal tort immunity rule" so that a municipality would be subject to liability just as any private employer. Abolition of this rule in North Carolina would not subject a municipality to liability for the negligent operation of its public service vehicles without regard to the emergency circumstances, as there would still remain the ordinary application of statutory privileges to ascertain what standard of care a municipal employee is to be held to in a given situation.

WILLIS D. BROWN.

Taxation—Gifts in Trust for Minors—Annual Exclusions

Section 1003 (b) (3) of the Internal Revenue Code provides that "In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 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." In determining what is a future interest within the meaning of section 1003 (b) (3), primary emphasis is placed upon the "use, possession and enjoyment" of the property rather than upon the vesting of the property in the donee. The Regulations stipulate that "Future interests' is a legal term, and includes reversions, remainders, and other interests or estates whether vested or contingent, and whether or not

Municipal tort immunity is an old subject of sharp attack. Green, Municipal Liability for Tort, 38 Ill. L. Rev. 126 (1944); Hobbs, The Tort Liability of Municipalities, 27 Va. L. Rev. 126 (1940); Warp, Can the "King" Do No Wrong?, 31 Nat'l Munic. Rev. 311 (1942); Notes, 14 N. C. L. Rev. 388 (1936), 22 N. Y. U. L. Q. Rev. 509 (1947), 24 Va. L. Rev. 86 (1937).

At least eight states (Cal., Ill., N. M., N. Y., Pa., S. C., W. Va., Wis.) impose, by statute, civil liability upon municipalities for the negligent operation of their motor vehicles in governmental functions.

Florida imposes liability on the municipality on the ground that reckless operation of its vehicles upon the streets constitutes a nuisance.

Fondren v. Commissioner, 324 U. S. 18 (1945); United States v. Pelzer, 312 U. S. 399 (1941); Commissioner v. Glos, 123 F. 2d 548 (7th Cir. 1941).

U. S. Treas. Reg. 108, §86.11. This regulation further provides that "The term 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 employed in effecting the gift."
supported by a particular interest or estate, which are limited to com-
merce in use, possession, or enjoyment at some future date or time."
Therefore, even though the donee's interest is vested, if he does not
also have the immediate right to the present enjoyment, use or posses-
sion of the property, the interest will be considered a future interest by
the court and the taxpayer will be denied the annual exclusion.4

The trust device is often utilized in making gifts to minors. At one
time there was some question as to whether the trust or the beneficiaries
of the trust were in fact the donees of the gift; however, it is now well
settled that the gift is to the beneficiaries and the taxpayer is entitled
to an annual exclusion for gifts made to each of them.5

If the donor wishes to employ the trust and still be able to take
advantage of the annual exclusion, many of the common trust provisions
must be eliminated. Provisions for the accumulation of income should
be avoided, for if the trustee is directed to accumulate income, the gift
is of a future interest and no annual exclusion is allowed.6 This is true
even though the period of accumulation is as short as three months.7
If the trustee is directed to pay off existing encumbrances on the trust
property out of income, it is the same as if the trustee were directed
to accumulate income.8 Also, if the trustee is permitted in his discretion
to use some of the income for the support, education and maintenance
of the child and to accumulate the balance, the gift is considered as a
future interest; for whether or not any part of the income will be avail-
able for the benefit of the child depends upon the discretion of the
trustee.9 The presence of spendthrift provisions10 in the trust is not
sufficient to make the gift one of a future interest,11 nor is the lack of
such provisions sufficient to create a present interest.12 A provision

4 Commissioner v. Diston, 325 U. S. 442 (1945) ; Fondren v. Commissioner,
324 U. S. 18 (1945) ; United States v. Knell, 149 F. 2d 331 (7th Cir. 1945) ; Com-
misioner v. Glos, 123 F. 2d 548 (7th Cir. 1941) ; Welch v. Paine, 120 F. 2d 141
(1st Cir. 1941) ; Estate of Ethel K. Childers, 10 T. C. 566 (1948).
5 United States v. Pelzer, 312 U. S. 399 (1941) ; Helvering v. Hutchings, 312
U. S. 393 (1941).
6 Commissioner v. Diston, 325 U. S. 442 (1945) ; United States v. Pelzer, 312
U. S. 399 (1941) ; Hessenbruch v. Commissioner, 178 F. 2d 785 (3rd Cir. 1950) ;
United States v. Knell, 149 F. 2d 331 (7th Cir. 1945) ; Welch v. Paine, 120 F. 2d
141 (1st Cir. 1941).
7 Hessenbruch v. Commissioner, 178 F. 2d 785 (3rd Cir. 1950).
8 Commissioner v. Brandegee, 123 F. 2d 59 (1st Cir. 1941). In Mary R. Nelson
v. Commissioner, 46 B. T. A. 653 (1942), the court pointed out that the gift could
be shown to be a present gift by proving that no encumbrances existed on the
property which would postpone the unqualified right to the income.
9 United States v. Knell, 149 F. 2d 331 (7th Cir. 1945) ; Hutchings-Sealy Nat'l
Bank v. Commissioner, 141 F. 2d 422 (5th Cir. 1944) ; Commissioner v. Taylor,
122 F. 2d 714 (7th Cir. 1941) ; Estate of Ethel K. Childers, 10 T. C. 566 (1948).
10 Generally speaking such provisions prohibit the beneficiary from alienating
his interest or anticipating or assigning the income.
12 Welch v. Paine, 120 F. 2d 141, 143 (1st Cir. 1941).
giving the beneficiaries the right to the use of the principal upon their joint request has been held to create a future interest, the contingency being that they both join in the exercise of the power. In another case, the trustee was directed to use the income necessary for the support, education and comfort of the minors, and the court held that the gift was a future interest unless there was some indication from the face of the trust or surrounding circumstances that a steady flow of some ascertainable portion of income would be required.

If the donor wishes to take advantage of the annual exclusion, he should be sure that the trust is so drafted that the value of the gift is capable of determination. For instance, if there is a present gift of income and the trustee, in his discretion, can use the principal for the benefit of the beneficiaries, the value of the gift of the income cannot be determined, for if and when the trustee does invade the corpus, the payments of the income will be proportionately reduced. This potential invasion of principal makes the value of the gift of the income unascertainable and the annual exclusion will be denied.

On the other hand, where the trustee is directed to make periodic payments of all or some definite part of the income to the minors, the gift is treated as one of a present interest and the annual exclusion is permitted to that extent. The dates of distribution of income do not have to be definite so long as the distribution is directed to be made at least annually, and the requirement that the minor be living at the date of distribution of income does not prevent the gift from being one of a present interest.

In a recent federal case arising in North Carolina, the taxpayer created an irrevocable trust for her four-year-old grandson. The trust provided that the beneficiary was to be paid all the income until he reached the age of twenty-one. The trustees were also directed to use for the support of the child such amounts of the principal as might be

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13 Ryerson v. United States, 312 U. S. 405 (1941).
15 In Helvering v. Blair, 121 F. 2d 945 (2nd Cir. 1941), the trustees were authorized to apportion income among the beneficiaries as they saw fit, and this authority rendered the computation of the value of any beneficiaries' share impossible, and the annual exclusion was denied. But see Commissioner v. Lowden, 131 F. 2d 127, 128 (7th Cir. 1942), where the court remarks that "To constitute a future interest mere uncertainty of amount must be co-existent with restrictions upon or postponement of immediate use and enjoyment."
16 Andrew Geller v. Commissioner, 9 T. C. 484 (1947); Margaret A. C. Ritter v. Commissioner, 3 T. C. 301 (1944). In Kniep v. Commissioner, 172 F. 2d 755 (8th Cir. 1949), there was a present gift of income but the trustee could, in his discretion, encroach upon the principal to the extent of $1,000 per year for each beneficiary. The court pointed out that the beneficiary could only be certain of receiving income from principal which had been reduced to this extent.
17 Commissioner v. Sharp, 153 F. 2d 163 (9th Cir. 1946).
directed by the court vested with jurisdiction of the person or the estate of the child during minority, to the same extent as if the trustees were the duly appointed guardians of the child's estate. The court, in holding that this was a gift of a present interest, pointed out that the trust made the same provisions which would have applied under North Carolina law if the gifts had been made outright to the minor and a guardian of the estate had been appointed.\(^{20}\) In another recent case,\(^{21}\) the terms of the trust provided that it could be terminated when the beneficiary or his legally appointed guardian should make due demand in writing. Although the minor was incapable of making a legal demand and there was no indication that a guardian would be appointed even if requested,\(^{22}\) the gift was considered one of a present interest. The court of appeals stated, "As heretofore shown, the fallaciousness of the Commissioner's contention is the failure to distinguish between restrictions and contingencies imposed by the donor (in this case the trust instrument) and such restrictions and contingencies as are due to disabilities always incident to and associated with minors and other incompetents. As to the former it is authoritatively settled that a gift upon which the donor imposes such conditions or restrictions is of a future interest. In the latter such restrictions as exist are imposed by law due to the fact that the beneficiary is incapable of acting on his own. It is our view, and we so hold, that such restrictions do not transform what otherwise would be a gift of a present interest to one of a future interest."\(^{23}\) A similar decision was reached in the Strekalovsky case\(^{24}\) where the trust provided that upon demand of any legally appointed guardian of any of the children, the entire share was to be paid to the guardian.

Evidently, these decisions were influenced by a dictum in Fondren v. Commissioner\(^{25}\) where the petitioner contended that unless the gifts were held to be present interests, then no gift to a minor could be so regarded, since someone had to exercise discretion as to the necessity and reasonable requirements of the beneficiary. The court held that the gifts were future interests but pointed out that it did not follow that all gifts to minors would be so treated. It further said that the petitioner's argument was appealing to the extent that it sought to avoid imputing to Congress the intention to penalize gifts to minors solely because of their legal disabilities,\(^{26}\) and indicated that whenever provisions were

\(^{20}\) Id. at 333.

\(^{21}\) Kieckhefer v. Commissioner, 189 F. 2d 118 (7th Cir. 1951).

\(^{22}\) This point was brought out in the Tax Court's decision which held that the gifts were future interests. 15 T. C. 111 (1950).

\(^{23}\) Kieckhefer v. Commissioner, supra at 122.


\(^{25}\) U. S. 18, 29 (1945).

\(^{26}\) When this case was in the court of appeals, Judge Waller, in a dissenting opinion, remarked "I hesitate to ascribe to Congress the absurd design to tax a
made for the immediate application of the gift for the benefit of the minor the exclusion would be allowed.

On the basis of these cases it seems that the taxpayer can make a present gift of the corpus or income of a trust to a minor\textsuperscript{27} by subjecting the trustee to the same restrictions as would be imposed upon the guardian of the minor’s estate by operation of law.\textsuperscript{28} However, until the matter is finally settled by the United States Supreme Court, the Commissioner might continue to assert that such gifts to persons under disability are prima facie taxable and subject the taxpayer to a deficiency assessment.\textsuperscript{29} Whether or not it would be advisable to employ the trust in making gifts to minors under such circumstances seems debatable.\textsuperscript{30} Nevertheless, if the settlor can in effect appoint the trustee as guardian of the estate,\textsuperscript{31} it is plausible that the benefits to be derived from the trusteeship would justify the risk of a possible deficiency assessment.\textsuperscript{32}

THOMAS M. MOORE.

\textbf{Workmen’s Compensation—Constitutional Law—Heart Disease as an Occupational Disease}

In 1949 the North Carolina General Assembly adopted an amendment to the Workmen’s Compensation Act which provided that certain heart diseases would be deemed occupational diseases for firemen.\textsuperscript{1} The gift to a babe in arms because his estate must be managed by some one sui juris, exercising the powers of a guardian or parent, while a gift to an adult, requiring no managing third party, is tax free. Congress likes adult voters, but surely not that well.\textsuperscript{141} F. 2d 419, 422 (5th Cir. 1944).

\textsuperscript{27} However, if the donor of the trust is legally obligated to support the beneficiary, then to the extent that the income of the trust is applied to the support or maintenance of the beneficiary, it will be treated as the income of the donor under INT. REV. CODE §167 (c). In Wallace Townsend, Exr. v. Thompson, CCH FEDERAL ESTATE AND GIFT TAX REPORTER §§10,780 (D. C. Ark. 1950), where the donor-trustee, who was the father of the child beneficiary, died before the minor attained majority, the court held that the corpus of the trust was to be included in the donor’s estate.

\textsuperscript{28} Fleming, Gifts for the Benefits of Minors, 49 MICH. L. REV. 529, 539 (1951). “The administration of the tax laws should be practical, so the argument runs, and a practical administration of the present interest test should regard the rights, controls, and enjoyment of the guardian as that of the minor.”

\textsuperscript{29} Anderson, Gifts to Children and Incapacitants, 26 TAXES 911, 916 (1948).

\textsuperscript{30} Drexler, The Exclusion Provision of the Gift Tax Law Needs Amending, 29 TAXES 743, 747 (1951), “… in many instances where the trust device continues to be employed, such as in the Strekalovsky and Kieckhefer cases, it has caused the basic provisions of the trust to be so fundamentally altered that it hardly constitutes a trust at all, as the term is traditionally understood.”

\textsuperscript{31} Cannon v. Roberson, 98 F. Supp. 331 (W. D. N. C. 1951).

\textsuperscript{32} As a practical matter, it seems that the donor could make a gift directly to the minor and then attempt to have someone who is in accord with his views appointed as guardian.

\textsuperscript{1} N. C. GEN. STAT. §97-53(26) (1950): “In case of members of fire departments of cities, counties or municipal corporations or political subdivisions of the state, whether such members are voluntary, partly paid or fully paid; coronary throm-