Rev. Rul. 76-103

Internal Revenue Service (I.R.S.)

Revenue Ruling

TRANSFER IN TRUST; ASSETS SUBJECT TO CLAIMS OF GRANTOR'S CREDITORS

26 CFR 25.2511-2: Cessation of donor's domination and control

Transfer in trust; assets subject to claims of grantor's creditors. The transfer of property to an irrevocable inter vivos trust created in, and administered under the laws of, a state in which the trust is deemed a "discretionary trust' whose assets are subject to claims of the grantor's creditors, does not constitute a completed gift.

Advice has been requested whether a completed gift has been made, for the purposes of the Federal gift tax, where an irrevocable trust is created under the circumstances described below.

The grantor created an irrevocable inter vivos trust on September 2, 1975. During the lifetime of the grantor, trust income may, in the absolute discretion of the trustee, be paid to the grantor or accumulated and added to principal. Any amount of trust principal may be distributed to the grantor at any time, in the absolute discretion of the trustee. Upon the death of the grantor, any remaining principal is payable to the issue of the grantor. The surrounding facts indicated that the trust had not been created primarily for the benefit of the grantor.

The trust was created in State *X* and has been administered under the laws of that State from the date of the transfer. The terms of the trust include, however, a provision allowing the trustee, in its absolute discretion, to move the situs of the trust to any other State.

Under the law of State *X*, the trust is a "discretionary trust' and the entire property of the trust may be subjected to the claims of the grantor's creditors, whenever such claims may arise.

The question presented is whether the transfer in trust is an incomplete gift for Federal gift tax purposes because the assets of the trust are subject to the claims of creditors of the grantor.

Under section 2511(a) of the Internal Revenue Code of 1954, the Federal gift tax is applicable to every transfer of property by gift, regardless of the nature of the property or the means by which the transfer is accomplished.

Section 25.2511-2 of the Gift Tax Regulations contains the following provisions:

(b) As to any property, or part thereof or interest therein, of which the donor has so parted with 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. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. For example, if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to

appoint the remainder among his descendants, no portion of the transfer is a completed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift. However, if the exercise of the trustee's power in favor of the grantor is limited by a fixed or ascertainable standard (see paragraph (g)(2) of § 25.2511-1), enforceable by or on behalf of the grantor, then the gift is incomplete to the extent of the ascertainable value of any rights thus retained by the grantor.

(c) A gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. * * *

In *Alice Spaulding Paolozzi,* 23 T.C. 182 (1954), *acq.* 1962-1 C.B. 4, a grantor empowered the trustees to determine how much of trust income should be distributed, in their absolute discretion, in the best interest of the grantor. Any unpaid income was to be added to principal. The Tax Court agreed with the petitioner's interpretation of Massachusetts law as allowing both prior and subsequent creditors of the grantor to reach the maximum amount of income that the trustees could in their discretion pay out to the grantor. The grantor could thus effectively enjoy all the trust income by relegating the creditors to the trust for settlement of their claims. Therefore, the court held that no taxable gift of trust income had been made.

In the present case, the law of State *X* is similar to that of Massachusetts when the *Paolozzi* case, above, was decided. As long as the trustee continues to administer the trust under the law of State *X,* the grantor retains dominion and control over the trust property.

Accordingly, in the instant case, the grantor's transfer of property to the trust does not constitute a completed gift for Federal gift tax purposes.

If and when the grantor's dominion and control of the trust assets ceases, such as by the trustee's decision to move the situs of the trust to a State where the grantor's creditors cannot reach the trust assets, then the gift is complete for Federal gift tax purposes under the rules set forth in section 25.2511-2 of the regulations (quoted above).

Furthermore, if the grantor dies before the gift becomes complete, the date of death value of the trust corpus will be includible in the grantor's gross estate, for Federal estate tax purposes, under section 2038 of the Code because of the grantor's retained power to, in effect, terminate the trust by relegating the grantor's creditors to the entire property of the trust.

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