
Rev. Rul. 77-378

Internal Revenue Service (I.R.S.)

Revenue Ruling

TRANSFER IN TRUST; INCOME AND PRINCIPAL TO GRANTOR AT TRUSTEE'S DISCRETION

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

Transfer in trust; income and principal to grantor at trustee's discretion. The transfer of property to an irrevocable inter vivos trust, under the terms of which the trustee has the discretionary power, entirely voluntary under the trust instrument and applicable state law, to distribute income and principal to the grantor constitutes a completed taxable gift of the entire value of the property transferred; Rev. Rul. 62-13 clarified.

Advice has been requested as to the application of the Federal gift tax to a transfer to a trust, in the circumstances described below.

On January 16, 1975, approximately one half of the grantor's income-producing property was conveyed to an irrevocable inter vivos trust created on that day. The terms of the trust require the trustee (a corporation) to accumulate income and add it to principal during the lifetime of the grantor. Upon the death of the grantor, the trust will terminate and its assets will be paid to the grantor's spouse and children.

Pursuant to the trust agreement the trustee was empowered to pay to the grantor such amounts of the trust's income and principal as it determines in its absolute and uncontrolled discretion. However, under the applicable state law the trustee's decision whether to distribute trust assets to the grantor is entirely voluntary. The grantor can not require that any of the trust's assets be distributed to the grantor nor can the creditors of the grantor reach any of the trust's assets.

The question presented is whether the grantor has parted with dominion and control of the property transferred so that the Federal gift tax is applicable to the transfer, in view of the power of the trustee to return the property to the grantor.

Section 2501 of the Internal Revenue Code of 1954 imposes a tax on any transfer of property by gift by any individual. Section 2511 provides for application of the gift tax regardless of the nature of the property transferred and whether the transfer is direct or indirect, or in trust or otherwise.

Section 25.2511-2(b) of the Gift Tax Regulations provides as follows:

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 section 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.

The gift tax is an excise tax upon the donor's act of making the transfer and is measured by the value of the property passing from the donor. The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. See section 25.2511-2(a) of the regulations.

Even though a trustee may have an unrestricted power to return all of the trust's assets to the grantor, if the grantor's interest in the trust is not enforceable either by the grantor or on the grantor's behalf, then the grantor has parted with dominion and control over the property transferred into trust. See section 25.2511-2(b) of the regulations. Furthermore, if the grantor retains such a mere expectancy that the trustee will distribute trust assets to the grantor rather than an enforceable interest in the trust, the expectancy does not prevent the completion or reduce the value of the gift. *Herzog v. Commissioner*, 41 B.T.A. 509 (1940), *aff'd*, 116 F.2d 591 (2nd Cir. 1941).

In *Herzog*, the grantor transferred assets in trust with instructions to the trustee to pay the income to the grantor or the grantor's wife at such times and in such amounts as the trustee should deem proper with a remainder over to certain named beneficiaries. On the same day the trust was created the trustee directed that all of the trust income be paid to the grantor. The grantor argued that for gift tax purposes the value of property transferred in trust should be reduced by an amount representing the value of the income for life receivable by the grantor if the trustee in the trustee's uncontrolled discretion should so direct. The Board of Tax Appeals stated:

There would be no doubt of his nonliability for gift tax upon the value of the income if he had reserved to himself the absolute right to the income for his life. But he made no such reservation. He transferred the entire property. Whether he would enjoy any of its income depended entirely on the trustee, who, in his uncontrolled discretion, could deprive him of it completely. It was only by virtue of the trustee's direction, which on this record must be regarded as entirely voluntary, that the donor received any of the income; and this direction might be terminated whenever the trustee deemed it proper that the wife should receive the income. Such a hope or passive expectancy is not a right. It is not enough to lessen the value of the property transferred. [41 B.T.A. at 510] (citations omitted).

Accordingly, the Board held that since the transfer by the grantor was complete the gift tax was, by its own terms, applicable to the value of the entire property transferred.

In the instant case, the grantor has parted with dominion and control over the property that the grantor transferred into trust. Although the trustee has an unrestricted power to pay trust assets to the grantor, the grantor cannot require that any of the trust's assets be distributed to the grantor nor can the grantor utilize the assets by going into debt and relegating the grantor's creditors to the trust. See *Paolozzi v. Commissioner*, 23 T.C. 182 (1954), *acq.*, 1962-2 C.B. 5. Whether the grantor would enjoy any of the trust's assets is dependent entirely on the uncontrolled discretion of the trustee. Such a hope or passive expectancy does not lessen the value of the property transferred. Accordingly, the Federal gift tax is applicable to the entire

value of the property transferred to the trust by the grantor.

In Rev. Rul. 62-13, 1962-1 C.B. 181, the Service announced that it would follow the decisions in *Commissioner v. Vander Weele*, 254 F.2d 895 (6th Cir. 1958) and *Gramm v. Commissioner*, 17 T.C. 1063 (1951), *acq.*, 1962-1 C.B. 4. In the *Vander Weele* and *Gramm* cases the courts held that the grantors of irrevocable inter vivos trusts had not completely parted with dominion and control over the trust assets since they retained enforceable rights to some or all of the trusts' assets. For example, in *Vander Weele*, the court noted that under state law the settlor could in actuality retain the economic benefit and enjoyment of the entire trust income and corpus by borrowing money or by selling, assigning, or transferring the grantor's interest in the trust fund and relegating the grantor's creditors to the trust fund for payment. 254 F.2d at 898. Thus, in view of the settlor's retained rights there was no assurance that anything of value would pass to the remaindermen and the gift was entirely incomplete. See *Holtz v. Commissioner*, 38 T.C. 37 (1962), *acq.*, 1962-2 C.B. 4. Also, the court in *Gramm* made it clear that where the grantor reserves no interest, the gift is complete. It did this by distinguishing *Herzog* on the ground that there "the grantor did not reserve the income to himself, and whether he received it or not was in the uncontrolled discretion of the trustee.' However, Rev. Rul. 62-13 may be read to imply that broad powers given to a trustee to invade trust income and corpus for the benefit of the grantor may be sufficient to render the gift incomplete even though the grantor's interest in the trust assets is unenforceable. Therefore, Rev. Rul. 62-13 is hereby clarified to remove any implication that an entirely voluntary power held by a trustee to distribute all of the trust's assets to the grantor is sufficient to render a gift incomplete either in whole or in part.

Accordingly, in the present case, the Federal gift tax is applicable to the entire value of the property transferred to the trust by the grantor.

Rev. Rul. 62-13 is clarified.

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