Jones v. Commissioner, 27 T.C. 209 (1956)

When a trust grants a trustee the power to encroach on the principal for the beneficiary's benefit, the value of the beneficiary's present interest in the income stream for gift tax exclusion purposes is still considered determinable if the power of encroachment is limited by an ascertainable standard and the likelihood of encroachment is remote.

Summary

The case concerns gift tax exclusions for trusts established by the taxpayer, Hugh McK. Jones, for his children and grandchildren. The IRS disallowed the exclusions, arguing that the trusts' encroachment provisions made the income interests' values indeterminable. The Tax Court held that the income interests of the children were sufficiently ascertainable to qualify for the gift tax exclusion because the encroachment power granted to the trustee was limited by a standard tied to the beneficiaries' accustomed standard of living and, considering their other assets, encroachment was unlikely. The court disallowed the exclusion for the grandchildren's trust, ruling the grandchildren's interests as future interests, as the trustees could use income and principal for support.

Facts

Hugh McK. Jones established five irrevocable trusts. Four were for his adult children, granting them the income for life, with the trustee having the power to encroach on the principal for their maintenance, education, and support, in accordance with their accustomed standard of living or in emergencies. The fifth trust was for his minor grandchildren, with the trustees able to use income and principal for their support and education until they reached a certain age. Jones claimed gift tax exclusions for these trusts, which the IRS disallowed. The beneficiaries of the children's trusts had substantial financial resources beyond those trusts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Jones's gift tax. The Tax Court reviewed the deficiencies, focusing on whether the exclusions claimed by Jones were proper under the Internal Revenue Code.

Issue(s)

1. Whether, in determining the amount of petitioner's gifts for the year 1951, should there be allowed four exclusions of not to exceed $3,000 each, in respect of the interests of his four living adult children in four separate irrevocable trusts?

2. Whether, in determining the amount of petitioner's gifts for 1951, there should be allowed four other exclusions in respect of the interests of four minor grandchildren

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of the petitioner in a fifth irrevocable trust?

Holding

1. Yes, because the value of the children's income interests was determinable due to the ascertainable standard limiting the trustee's encroachment power and the remoteness of encroachment given the beneficiaries' other resources.

2. No, because the grandchildren's interests were considered future interests.

Court's Reasoning

The court applied the principles of gift tax law, specifically focusing on I.R.C. § 1003(b), which allows exclusions for gifts of present interests. The court recognized that gifts in trust are considered gifts to the beneficiaries, and that the right to receive income is a present interest. Where a trustee has the power to encroach on the principal of the trust, that power also affects how the present interest is viewed. The court determined that the trustee's encroachment power was limited by an ascertainable standard tied to the beneficiary's accustomed standard of living, and that the possibility of encroachment was remote, given that the beneficiaries had substantial other resources. The court cited: "Ithaca Trust Co. v. United States, 279 U. S. 151, 154."

With respect to the grandchildren, the Court determined that the trustees were able to use the income and principal of their trust for the beneficiaries' support, which created an inherent uncertainty that the interests were present and determinable, thus, the court deemed the grandchildren's interests future interests.

Practical Implications

This case provides guidance for attorneys advising clients on estate planning and gift tax implications. It clarifies that a gift tax exclusion can be available even with an encroachment provision if the provision is limited by an ascertainable standard, and the likelihood of the encroachment occurring is remote. Estate planners must carefully draft trust documents to include standards for encroachment that can be objectively measured. Further, the case emphasizes the importance of considering the beneficiaries' other assets and financial situations when evaluating whether an income interest qualifies for the gift tax exclusion. It confirms that if a trustee has the power to use income and principal for the support of the beneficiaries, the beneficiary's interest will be considered a future interest.

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