33 T.C. 629 (1960)

The amount of a gift for gift tax purposes is the value of the property transferred, undiminished by expenses incident to the administration of the trust. Gifts of interests in trust income are considered gifts of future interests if the trustee has the discretion to distribute the principal, thereby affecting the income stream, and as such, do not qualify for the annual gift tax exclusion.

Summary

The case concerns gift tax liability. The petitioner created an irrevocable trust, transferring $66,000 in cash, from which the corporate trustee received a commission of $750. The court determined the gift's value was $66,000, undiminished by the trustee's commission. The petitioner also claimed gift tax exclusions for life interests in trust income for her son and minor grandchildren. The court denied these exclusions, finding that the trustee's discretion to distribute the trust's principal made the interests future interests, and thus ineligible for the exclusion. Because of the unlimited discretion, there was no way to value the interests, and no exclusion was allowed.

Facts

Farha Schayek established an irrevocable trust on April 14, 1953, with the City Bank Farmers Trust Company as a corporate trustee and Louise Schayek, the petitioner's daughter, as an individual trustee, transferring $66,000 in cash. The corporate trustee immediately received a $750 initial commission. The beneficiaries were Schayek's son, David, and his two minor daughters. The trust's terms allowed the trustees to distribute income and, without limitation, principal. The trustees distributed income to the beneficiaries. Schayek reported the gift as $65,250 (subtracting the commission) on her gift tax return and claimed three $3,000 exclusions for the beneficiaries. The IRS determined the gift was $66,000 and disallowed the exclusions.

Procedural History

The IRS determined a gift tax deficiency. The petitioner filed a petition with the U.S. Tax Court contesting the deficiency, specifically the valuation of the gift and the disallowance of gift tax exclusions. The IRS amended its answer seeking an increase in the deficiency. The Tax Court heard the case and issued its opinion.

Issue(s)

1. Whether the amount of the gift to the trust was $66,000 or $65,250, reduced by the trustee's initial commission.

2. Whether the petitioner was entitled to three $3,000 gift tax exclusions for the beneficiaries' life interests in the trust income under section 1003(b)(3) of the 1939

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Code.

Holding

1. No, because the gift was valued at $66,000, the amount transferred to the trust, without reduction for the trustee's commission, because it was an administrative expense.

2. No, because the gifts of the minor grandchildren's interests in the trust income were future interests; even if considered present interests, the interests could not be valued because of the trustees' unlimited discretion to distribute principal, so no exclusions were allowable.

Court's Reasoning

The court cited E.T. 7, which holds the value of the transferred property at the date of transfer constitutes the amount of the gift for gift tax purposes. It emphasized that gift tax is an excise on the transfer of property by the donor and is measured by the property's value passing from the donor, not the value received by the donee. Therefore, the $750 commission, an administrative expense, did not diminish the gift's value, which was the $66,000 transferred in cash. Regarding the exclusions, the court determined that because the trustees could distribute the entire corpus of the trust to the beneficiaries, their income interest was not ascertainable and could not be valued. As a result, the gifts to David and his daughters were gifts of future interests. The court relied on precedent establishing that the discretion of a trustee to withhold income or distribute principal renders a beneficiary's interest a future interest, preventing the annual gift tax exclusion. The court specifically referenced that "where a donee's enjoyment and use of a gift are subject to the exercise of the discretion of a trustee, the donee's interest is a future interest and the statutory exclusion has been denied."

Practical Implications

This case underscores that the full value of the property transferred, regardless of administrative expenses, determines the gift tax valuation. Attorneys must be careful when structuring trusts and gift plans where gift tax exclusions are desired. If the trust agreement grants the trustee broad discretion to invade principal, the beneficiaries' income interests may be deemed future interests, losing the annual exclusion. This case reinforces the need to consider and carefully draft the terms of a trust to ensure that beneficiaries' interests are sufficiently defined and present to qualify for the annual gift tax exclusion. This case serves as a warning that unlimited trustee discretion could preclude gift tax exclusions for transfers in trust. Lawyers drafting trust agreements must balance the grantor's goals with the tax consequences and, where appropriate, limit the trustee's discretion to ensure the availability of tax exclusions.

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