

When is it a Gift?

Quick-Take: This may come as a surprise to some, but the Tax Code does not provide a formal definition of a *gift* on which the federal gift tax is imposed.

Tax Code: The Tax Code clearly states that a gift tax applies on the transfer of property by *gift* during the calendar year. [IRC 2501(a)(1).] So a gift tax is imposed under the Tax Code, yet *gift* is not formally defined by that Tax Code. Welcome to the world of tax law!

Courts: The U.S. Supreme Court, however, has stepped in to provide a somewhat workable definition of *gift* that is followed by the federal Courts and, no doubt grudgingly, by the IRS.

Detached Generosity: In *Commissioner v. Duberstein*, 363 U.S. 278 (1960) the Court noted that “*gift in the statutory sense...[as] proceed[ing] from a ‘detached and disinterested generosity’...out of affection, respect, admiration, charity or like impulses.*” The Court also noted that “*we have repeatedly emphasized that [the Code’s] comprehensive language was chosen to embrace all gratuitous transfers...The capacious language of Internal Revenue Code Sections 2501(a)(1) and 2511(a)...encompasses all gratuitous transfers of property rights of significant value.*” *Irvine v. United States*, 511 U.S. at 232

Donative Intent Required: Thus, a *gratuitous* transfer, not just a transfer of property, is required to impose the federal gift tax. There must be a finding of the donor’s donative or gratuitous intent for the federal gift tax to be imposed.

Transfer in Exchange for Consideration: Nor is a transfer of property in exchange for full and adequate consideration considered to be a taxable *gift*. *Estate of Redstone v United States*, 145 Tax Court 259 (2015). Treasury Regulations even note that a gift tax is not applicable to a transfer of property for full and adequate consideration in money or money’s worth. [Regulation 25.2511-1(g)(1).]

Incomplete Gifts: Nor will the federal gift tax be imposed if the claimed transferor retains full dominion and control over the potential disposition of the assets. A retention of control over the disposition of trust property, whether for the benefit of the donor or others, renders the gift incomplete until the retained power is relinquished by the donor whether in life or at death. *Robinson v.*

Commissioner, 675 F2d 774 (5th Cir. 1982.) The Regulations provide that “a gift is incomplete in every instance in which a donor reserves the power to re-vest the beneficial title in the property [herself.]” [Regulation 25.2511-2(c).] Which is why, to avoid making a taxable gift on occasion a donor will retain a limited power of appointment over the transferred property in trust, to thus retain enough control with the exercise of the limited power of appointment to avoid the incidence of the federal gift tax.

Trust Modifications: These rules regarding *gift* are important to keep in mind as the IRS is prepared to launch new attack on trust modifications, where the IRS claims that the beneficiaries of the trust who participate by consent in the trust’s modification, or trust remainder beneficiaries who do nothing and who may not even know the trust is being modified, are treated by the IRS as making a taxable *gift* if their interest in the trust shrinks in any manner as a result of the trust’s modification. This becomes problematic for trust beneficiaries who watch modification proceedings without any active participant in those proceedings or who simply stand by and watch without taking any affirmative action in support of the trust’s modification. The IRS will not tell those trust beneficiaries how to go about valuing their interests in the trust (which may be conditional or contingent on them surviving to a future time or event, yet it still claims that a taxable *gift* has occurred on the modification or decanting of the trust. For example, how will a remainder beneficiary’s interest in a modified trust be valued if the trustee initially has the sole discretion to invade trust principal for the lifetime beneficiary’s support or welfare?

Conclusion: Expect to see a lot of activity by the IRS in the coming years asserting taxable *gifts* as more and more trustees take advantage of the numerous trust modification provisions in the Michigan Trust Code, or its trust decanting provisions, to change the terms of the trust with a notice to remainder beneficiaries, but without requiring actual consent by those remainder beneficiaries to the changed trust terms.

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