Gift Tax--Gift to Minor Qualifying for Section 2503 Exclusion

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had been specifically left out of the 1954 Code. The court stated that it would "not legislate, nor shall the Service, in an area specifically reserved to Congress." The court concluded that what is transferred when a premium is paid is only the dollar amount of the premium.  

It should be noted that the Commissioner in Gorman did not appear to concentrate on the point that the insured died only one year after the policy was taken out. It seems that the commissioner could have argued that, although the insured never technically possessed any of the incidents of ownership, he, in substance, purchased and subsequently transferred the policy to his wife. Since this purchase was made within three years of his death, it could have reasonably been argued that this amounted to a transfer of the policy itself under section 2035 of the Code.

Gorman has again opened the question of what should be included in an insured's estate under section 2035 when he possesses no incidents of ownership in a policy on his life, but has continued to pay the premiums on the policy. The case rejected the Service's attempt to apply the premium payment test, which was left out of the 1954 Code and held that only the amount of premiums paid by the insured within three years of his death are to be included in his estate.

E. Lee Schlaegel, Jr.

Gift Tax—Gift to Minor Qualifying for Section 2503 Exclusion

In 1962 the Crummeys established an irrevocable trust for the benefit of their four children, three of whom were minors. The terms of the trust provided for accumulation of the trust income, except for distributions to a needy beneficiary, until each minor reached the age of twenty-one. From age twenty-one to thirty-five all income was to be distributed to the beneficiaries and from age thirty-five on, the trustee was to control distribution of both in-

1954 Code, the Liebmann case is not authority for the proposition that payment of premiums transfers an interest in the policy. The Gorman case also holds that the Chase Nat'l Bank case "did not demonstrate that transfer occurs with the payment of each premium, in fact it was not even considered by the court. . . . The court never considered the relationship of premiums with proceeds." Gorman v. United States, 22 AFTR2d ¶ 147,241, at 147,990.42 (E.D. Mich. 1968).


15 Id. at 147,990.46-47.
come and corpus. Aside from the actions of the trustee, the only way the beneficiaries could reach the trust property was through a demand clause which provided that in any year in which an addition was made to the trust each beneficiary could demand, through his guardian if he was a minor, $4,000 or the amount of the addition from each donor, whichever was less. In 1962 and 1963, the Crummeys made additions to the trust of approximately $108,000 and $26,000 respectively. The Crummeys each claimed a $3,000 gift tax exclusion for each of the four beneficiaries in both years. The children never exercised their options under the demand clause. In disallowing the exclusions claimed for the minor children, the Commissioner ruled that the additions to the trust were future interests and hence did not qualify for the exclusion. Held, reversed. The demand clause in the trust instrument conferred upon the beneficiaries the legal right to demand the amount of the additions to the trust and thus rendered the additions of the Crummeys present interests to which the claimed exclusions applied. *Crumney v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

In this case the effect of the demand clause was to allow a gift tax exclusion and at the same time allow the settlors of the trust to effectively avoid the requirements of section 2503 (c) of the Internal Revenue Code. Generally in order for a donor to avail himself of the $3,000 gift tax exclusion, he must give a present interest and not a future interest. However, a gift to a minor that otherwise might be treated as a future interest can qualify for the exclusion under section 2503 (c) if two distinct requirements are met. First, the minor donee, or one acting for him, must be able to expend

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1 *E.g.*, INT. REV. CODE of 1954, § 2503(c):
Transfer for the Benefit of Minor—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and income therefrom—
(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and
(2) will to the extent not so expended—
(A) pass to the donee on his attaining the age of 21 years, and
(B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment. . . .

2 INT. REV. CODE of 1954, § 2503.
"Future interests" is a legal term which includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date of time. Fondren v. Commissioner, 324 U.S. 18, 20 (1954). *See also* C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 33.5 (2d ed. 1962).
for his benefit the property given and the income therefrom before he reaches twenty-one. Second, to the extent not so expended, the property must pass to the donee upon his reaching twenty-one, or to his estate if he should die prior to majority. The demand clause was utilized in the instant case to avoid compliance with these requirements and yet to qualify the gift as a present interest. Considering the existence of the demand clause and that the children could possibly reach the gift prior to majority, the court held that the requirements of section 2503(c) were fulfilled and the gifts were held to be present interests which qualified for the gift tax exclusions.

The effectiveness of the demand clause in creating a present interest, thus enabling the settlor to claim an exclusion, depends upon the test used to determine what constitutes a present interest. In the Crummey case the Commissioner relied primarily on the Stifel test, which is best stated as follows: As a practical matter, taking into account the surrounding circumstances as well as the trust instrument, could the minor children of the Crummeys make an effective demand upon the trustee? Since there had been no guardian appointed for the children and the additions were made at the close of the year, the Commissioner concluded that the rights of the minors were merely "paper rights" and the gifts to the minors were future interests which did not qualify for a gift tax exclusion.

Thus, it can be seen that the Stifel test may be criticized since it requires the IRS to make a conceivably speculative determination of who is likely under the circumstances to make an effective demand.

The second test discussed in the case, the Kieckhefer test, provides that where any restriction on use is caused by disabilities of a minor rather than by the terms of the trust, the gift is a present interest. The important factor in this test is that the minor have a legal right to enjoy the gift rather than the practical matter of being able actually to enjoy it. The Kieckhefer test is almost

3 INT. REV. CODE of 1954, § 2503(c)(2)(B).
4 Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952).
5 Crummey v. Commissioner, 397 F.2d 82, 84 (9th Cir. 1968).
6 Kieckhefer v. Commissioner, 189 F.2d 118, 122 (7th Cir. 1951). The Kieckhefer test has been approved, or a similar test adopted, in the following circuits: United States v. Baker, 236 F.2d 317, 320 (4th Cir. 1956); Gilmore v. Commissioner, 213 F.2d 520, 522 (6th Cir. 1954); Trust No. 3 v. Commissioner, 285 F. 2d 102, 106 (7th Cir. 1960); Knipe v. Commissioner, 172 F.2d 755, 756 (8th Cir. 1949); Commissioner v. Sharp, 153 F.2d 163, 165 (9th Cir. 1946). Although the last two decisions were rendered before Kieckhefer, the tests adopted were basically the same.
theoretical in its approach in that it does not look beyond the trust instrument for the practical difficulties that a minor might encounter. However, it does have the advantage of being less subject to uncertainty in establishing a standard as to what are gifts of a present interest to minors, since only legal principles are considered. In rejecting this test, the court pointed out that in Kieckhefer the income was to be accumulated until the minor was twenty-one (unless a demand was made) and at that time the whole trust was to be turned over to him, whereas in the present case, if no demand was made in the year an addition was made, it was forever removed from the uncontrolled reach of the beneficiaries. Under the general language of Kieckhefer, however, the exclusions claimed by the Crummeys would probably be allowable since the beneficiaries did have at least a legal right to reach the gifts.

The test ultimately relied on by the court, the Perkins test, provides that gifts are present interests if the minor children could have possibly gained immediate enjoyment from the gifts. The Perkins test is a compromise between the Stifel and Kieckhefer tests and takes into account some of the practical circumstances without emphasizing them to the extent of the Stifel test. In applying the Perkins test, it was necessary for the court to consider the trust instrument and the laws of California pertaining to minors in order to determine the result.

In California, a minor may receive a gift and own property. Thus, the court concluded that the parents could have given the gift directly to the children. A minor in California can demand his funds from a bank, savings institution, of a corporation, and the court reasoned he could make a similar demand of a trustee. Although no guardian had been appointed for the minor children in this case, children in California of the age of fourteen or over have the right to secure the appointment of a guardian if necessary and convenient. Although California minors cannot sue in their own names (a fact the Commissioner emphasized very strongly)

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7 George W. Perkins, 27 T.C. 601, 606 (1956).
8 DeLevillain v. Evans, 39 Cal. 120, 123 (1870).
11 Id. §§ 7600, 7606.
or appoint an agent, the court stated that a lawsuit or the appointment of an agent was not a necessary prelude to the making of an effective demand. The parent of a child in California is the natural guardian, but such guardianship is of the person of the child and not of his estate. This would allow the parents to make the demand upon the trustee for the children but would require a legal guardian to receive the property. This review of the California law indicates that the minor children of the Crummeys could have conceivably gained immediate enjoyment of the additions, that is, could have demanded and received the additions themselves.

Thus, the state laws regarding the rights of minors are critical in determining the outcome when the Perkins test is applied. West Virginia's laws are quite similar to California's with respect to a minor's rights. In both states a minor can receive a gift and own property; he can also demand his own funds from a bank, a savings institution, or a corporation. While a minor in California has the right to secure the appointment of a guardian if he is fourteen years old or over, a minor in West Virginia has the right to nominate his own guardian who will be appointed if approved by the county court; or if not approved, the court will appoint one for him. In neither state can a minor sue in his own name, nor

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15 Id. §33.
16 Crumney v. Commissioner, 397 F.2d 82, 87 (9th Cir. 1968).
18 DeLevillain v. Evans, 39 Cal. 120, 123 (1870); The Uniform Gifts to Minors Act, W. Va. Code ch. 36, art. 7, § 1, et. seq. (Michie 1966) provides for the gift to be given to a custodian to hold for the minor. However, this is not the exclusive method of making a gift to a minor. See W. Va. Code ch. 36, art. 7, § 9(b) (Michie 1966). It is a well established principle of common law that a minor can receive a gift, and if it is beneficial, the law will presume acceptance. McKinnon v. First Nat'l Bank of Pensacola, 77 Fla. 777, 780, 82 So. 748, 749 (1919); Copeland v. Summers, 138 Ind. 219, 223, 35 N.E. 514, 515 (1893); Davis v. Garrett, 91 Tenn. 147, 152, 18 S.W. 113, 114 (1892). Although there are no West Virginia cases in point, the West Virginia court would probably follow this time-honored rule.
can he appoint an agent.26 Under California law, the parent is the natural guardian of the child, but he is only guardian of the person of the child and not of the child's estate.27 Likewise, in West Virginia, the father is the natural guardian of the child's person,28 but only an appointed guardian who has given bond is entitled to manage his ward's estate.29 Like California, it would seem possible for the parent as natural guardian to make the demand of the trustee in West Virginia. Since the laws regarding minors are similar in both states and since both the Fourth Circuit and the Ninth Circuit have adopted a like test for determining the existence of present interests for purposes of the gift tax exclusion, it would seem probable that a federal district court applying West Virginia law to a similar situation would reach a decision in accord with the present case.

Since the particular test adopted by the court, and the applicable state laws pertaining to minors are both important in determining whether a present interest is created when a trust for minors is established, there is the logical question of the effectiveness of the demand clause in avoiding the strictures of section 2503(c) of the Internal Revenue Code. Many find it objectionable to have the entire trust, both corpus and income, pass absolutely to the beneficiary upon his reaching twenty-one as is required by section 2503(c) in order to qualify for a gift tax exclusion. This demand clause would seem to be a method by which this requirement could be avoided. However, the Crummeq case was apparently decided on its own set of facts, and should not be looked to as a safe harbor to avoid the onerous requirements of section 2503(c). The court conceded that different results would be obtained depending upon the test used for determining present interests. The court also stated,

We decline to follow the strict reading of the Stifel case in our situation because we feel that the solution suggested by that case is inconsistent and unfair. . . . In another case we might

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28 Rust v. Vanvacter, 9 W. Va. 600, 612 (1866).
follow the broader Kieckhefer rule, since it seems least arbitrary and establishes a clear standard.\textsuperscript{30}

Such language seems to indicate that the court is not completely sure of its position and one could not confidently rely on the demand clause as set out in this case to avoid the restrictions of section 2503(c). Yet, the donor who has decided not to utilize section 2503(c) because of the attendant restrictions might nevertheless insert a demand clause as was employed in the Crummey case; he would have nothing to lose.

\textit{Larry Losch}

\textbf{Res Judicata—Collateral Estoppel—Application Between Former Codefendants}

The plaintiff Schwartz sought to recover damages against the defendant administrator of Panoff's estate for injuries resulting from an automobile accident which occurred when a vehicle, operated by Schwartz, in which others were passengers, collided with a vehicle owned by Panoff. This action succeeded one brought jointly against Schwartz and Panoff by the passengers in Schwartz's car, wherein the passengers were awarded judgment against both on the grounds of the joint negligence of the two drivers. Defendant contended that the first judgment precluded any relief sought by Schwartz, since his negligence had been determined in the prior action and thus rendered him contributorily negligent and unable to recover in the second action. This contention was rejected and defendant appealed. \textit{Held}, reversed. Schwartz is collaterally estopped from bringing suit as the issue of his negligence has been determined in the prior action. \textit{Schwartz v. Public Administrator of County of Bronx}, 30 App. Div. 2d 193, 291 N.Y.S.2d 151 (1968).

In sustaining the defense of res judicata, the court pointed out that the factual situation required the application of that aspect of res judicata referred to as collateral estoppel. Thus, the decision raises a question as to the distinction between the two concepts.

Although both aspects of res judicata, merger and bar and collateral estoppel, have the same general objective—judicial finality—they are distinct in their operation.\textsuperscript{1} That aspect of res judicata re-

\textsuperscript{30} Crummey v. Commissioner, 397 F.2d 82, 88 (9th Cir. 1968).
\textsuperscript{1} Southern Pac. R.R. v. United States, 168 U.S. 1, 48-49 (1897).