

## Section 2511

### 26 CFR 25.2511-1: Transfers in general.

Treatment for Federal gift tax purposes of property transferred in the State of Washington pursuant to a written agreement between spouses that all property owned or acquired by them shall be community property. See Rev. Rul. 77-359, page 24.

### 26 CFR 25.2511-2: Cessation of donor's dominion and control. (Also Section 2522; 25.2522(c)-3.)

**Transfer in trust; rights retained by grantor.** Creation of a trust that provides for reversion of principle to the grantor or the grantor's estate after ten years and one month and for distribution of the annual net income to beneficiaries described in sections 170(c) and 2522 of the Code in accordance with the grantor's designation made prior to the beginning of the year or, upon the grantor's failure to so designate, in accordance with the trustee's selection at the end of the year, does not constitute a completed gift. The exercise or lapse of the grantor's power to designate the beneficiary will result in a completed gift; however, no deduction is allowable by virtue of section 2522(c)(2).

### Rev. Rul. 77-275

Advice has been requested as to the Federal gift tax consequences of a transfer to a trust, described below, that will revert to the grantor ten years and one month from the date of creation of the trust.

On January 24, 1976, A established a trust and transferred to the trustee 1x dollars. Under the terms of the trust, the transferred property is to be irrevocably held for ten years and one month, after which it will revert to A or to A's estate if A dies within the term of the trust.

During the ten year period, trust income is payable in accordance with the following provision:

The trustee shall at the end of each year irrevocably distribute the entire current net income solely and exclusively for edu-

cational, literary, charitable or other purposes specified in sections 170(c) and 2522 of the Internal Revenue Code to organizations or beneficiaries described in sections 170(c) and 2522, such distribution of the entire current net income to be made in accordance with the designation of the Settlor in his complete discretion, provided such designation shall be made by the Settlor prior to the beginning of such year.

In the absence of the designation by A, prior to the beginning of the year, of a charitable organization to receive income from the trust, the trustee is empowered to select the charitable beneficiary at the end of the year and distribute that year's income to the selected organization.

The questions presented are whether A made a gift for purposes of the Federal gift tax upon creation of the trust, or at any other time, and whether a charitable deduction is allowable with respect to any includible gift.

Under section 2511 of the Code, the gift tax is applicable to a transfer whether it is in trust or otherwise, whether the gift is direct or indirect, and whether the transferred property is real or personal, tangible or intangible.

Section 2522 of the Code provides for a deduction, in computing taxable gifts for a calendar quarter, of the value of property transferred to charitable organizations and purposes described in section 2522(a). Section 2522(c)(2) sets forth the following restriction on the deduction:

Where a donor transfers an interest in property (other than an interest described in section 170(f)(3)(B)) to a person, or for a use, described in subsection (a) or (b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b), no deduction shall be allowed under this section for the interest which is, or has been transferred to the person, or for the use, described in subsection (a) or (b), unless—

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in sec-

tion 664) or a pooled income fund (described in section 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

Section 25.2511-2 of the Gift Tax Regulations provides, in part, as follows:

Cessation of donor's dominion and control. (a) \* \* \*

(b) 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. \* \* \*

(c) A gift is incomplete in every instance in which a donor reserves the power to re-vest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. \* \* \*

\* \* \* \* \*

(f) The relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event that completes the gift and causes the tax to apply. For example, if A transfers property in trust for the benefit of B and C but reserves the power as trustee to change the proportionate interests of B and C, and if A thereafter has another person appointed trustee in place of himself, such later relinquishment of the power by A to the new trustee completes the gift of the transferred property, whether or not the new trustee has a substantial adverse interest. The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself) during the interim between the making of the initial transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the power, and constitutes a gift of such income or such other enjoyment taxable as of the calendar quarter or calendar year of its receipt.

Section 25.2522(c)-3(c) of the regulations provides, in part, as follows:

(c) Transfers of partial interests in property—(1) Disallowance of deduction. If a donor transfers an interest in property after July 31, 1969, for charitable purposes and an interest in the same property is retained by the donor, or is transferred or has been transferred for private purposes after such date (for less than an adequate and full consideration in money or money's worth), no deduction is allowed under section 2522 for the value of the interest which is transferred or has been transferred for charitable purposes unless the interest in property is a deductible interest described in subparagraph (2) of this paragraph. The principles that are used in applying section 2523 and the regulations thereunder shall apply for purposes of determining under this subparagraph whether an interest in property is retained by the donor, or is transferred or has been transferred by the donor. If, however, as of the date of the gift, a retention of an interest by a donor, or a transfer for a private purpose, is dependent upon the performance of some act or the happening of a precedent event in order that it may become effective, an interest in property will be considered retained by the donor, or transferred for a private purpose, unless the possibility of occurrence of such act or event is so remote as to be negligible. The application of this subparagraph may be illustrated by the following examples, in each of which it is assumed that the property interest which is transferred for private purposes is not transferred for an adequate and full consideration in money or money's worth:

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*Example (3).* H transfers Blackacre to A by gift, reserving the right to the rentals of Blackacre for a term of 20 years. After 4 years H transfers the right to the remaining rentals to charity. For purposes of this subparagraph the term "property" refers to Blackacre, and the right to rentals from Blackacre consist of an interest in Blackacre. An interest in Blackacre has been transferred by H for charitable purposes and for private purposes.

In the present case, A retained the power to designate, from time to time, the income beneficiary of the trust. This power is not a fiduciary power limited by a fixed or ascertainable standard. On the contrary, it extends to the entire trust income. Therefore, the gift of the income interest in the trust is incomplete, in view of section 25.2511-2(c) of the regulations, quoted above. No completed gift of the trust principal was made because the

donor retained the right to its reversion after termination of the trust.

The termination of A's power to designate income beneficiaries, either by exercise or release, will constitute a completed gift of any income interest in the trust for the period with which the termination is concerned. See section 25.2511-2(f) of the regulation, quoted above. For example, if A designates a particular charitable organization to receive the trust income for the first 3 years, A has made a completed gift of the right to trust income for those 3 years because A has no remaining dominion or control over the income during that period. Similarly, if A fails to designate a particular charity to receive the income for a specific year, the lapse of A's power to designate a charitable recipient is a gift of the income interest in the trust for that year. See section 25.2511-2(f) of the regulations, quoted above.

Under the terms of the trust instrument, the gift of the right to trust income for any year will always occur before the income for that year is earned. Since the right to one year's future income from the trust property cannot be severed from the trust property itself, the designation or the lapse of A's right to designate accomplishes a transfer of an interest in the trust property. At the same time, the donor, A, has retained an interest in the same property by virtue of A's right to the reversion. Section 2522(c) of the Code, quoted above, is thus applicable because interests in the same property will have been transferred to a charitable organization and also retained by the transferor. See example 3 in section 25.2522(c)-3(c)(1) of the regulations, quoted above.

Application of section 2522 of the Code to a completed gift by A when A exercises the power to designate the charitable organization to receive future income requires disallowance of the charitable deduction with respect to the transferred right to income. Section 2522(c)(2), quoted above, requires that the interest of charity con-

sist of either a remainder interest of one of the types specified in section 2522(c)(2)(A), or a guaranteed annuity or fixed percentage of the fair market value of the property (determined yearly) as prescribed in section 2522(c)(2)(B). The income interest of charity in the present case is not one of the types of interests described above. Therefore, no charitable deduction is allowable with respect to the designation by A of the recipient of future income from the trust.

If the trust had provided for A's designation to be made after the end of the year in which the income was earned, the gift occurring by reason of A's designation, or by the lapse of the right to designate, would be a gift of money, separate from the trust property itself, and thus a deduction would be allowable under section 2522 of the Code.

Accordingly, in the present case, no gift was made by A, for Federal gift tax purposes, upon creation of the trust described above. At the time of a designation by A of a charitable organization to receive income to be earned after the designation, or upon the lapse of A's power to designate, a completed gift will have been made by A of the present value of the transferred right to future income. No deduction is allowable under section 2522 of the Code with respect to such a completed gift due to A's retained right to reversion of the trust property upon termination and because the income right is not in the form prescribed by section 2522(c)(2).

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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 prin-