

DISCRETIONARY TRUST INTEREST HAS A GIFT TAX VALUE, BUT WHAT IS IT?

WEDNESDAY, JULY 06, 2011

In a recent Private Letter Ruling, a current trust beneficiary was entitled to income only in the discretion of the trustee, and was entitled to principal in the discretion of the trustee as needed for the beneficiary's health, support or maintenance. The trust beneficiaries and trustee are seeking State court approval for an early distribution of a portion of principal to the remaindermen, since it appears they would not otherwise be entitled to any distributions until the death of the current trust beneficiary.

The current trust beneficiary has advised the IRS that her income and resources are sufficient to maintain her current standard of living for her lifetime and any foreseeable emergencies, that she has received no trust distributions, and based on her financial condition she will not qualify for distributions from the trust. The trustee has represented that distributions would be made to the current trust beneficiary only in case of emergency.

Thus, the IRS was advised that the chances of a distribution being made to the current trust beneficiary during her lifetime are between slim and none. Based on that, the current beneficiary sought a ruling that her cooperation in allowing the early distribution of a portion of the principal to the remaindermen would not be a taxable gift.

The IRS ruled that a gift would occur with such a distribution. The gift arises by reason of the current beneficiary giving up the ability to receive income or principal from the principal amount that will be distributed, and that such transfer is a gratuitous and taxable transfer to the remaindermen. Regardless of the lack of likelihood of a distribution ever being made to the current beneficiary, the possibility remains.

This is a fair and appropriate legal analysis. The practical issue is how to value the gift? This is a fact question and not something the IRS would rule on, although the ruling does concede that the value may be nominal. When dealing with gifts involving

discretionary interests, and even ascertainable standards, this is a common valuation question, but one that begs a practical solution.

I would be interested to hear via the comment section from any readers how they deal with these valuation issues.

Private Letter Ruling 201122007

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