Comparison of Washington and Federal Gift Taxes

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COMMENT:
COMPARISON OF WASHINGTON AND FEDERAL
GIFT TAXES

Generally, federal gift tax consequences are uppermost in the Washington lawyer's mind when he deals with gift tax problems. Consequently, certain differences in the Washington gift tax law are inadvertently overlooked. Although the Washington Act was patterned after the federal act of 1932, several important areas of difference do exist between the two statutes. The purpose of this comment is to explain portions of the Washington gift tax statute, while comparing and contrasting it with the Internal Revenue Code of 1954.

The dearth of cases construing the Washington gift tax statute presents a problem in areas where the statute is ambiguous. Since the Washington State Tax Commission's gift tax regulations merely paraphrase the statute, federal case law and regulations have been relied upon in areas where the Washington and the federal statutes are substantially the same. As a practical matter, these are the only sources available to the Washington lawyer. The worth of such federal authority is questionable since the Washington Tax Commission will not necessarily follow federal precedent. As a practical matter, a phone call to the "Division" may save many headaches.

TRANSFERS SUBJECT TO GIFT TAX

No apparent difference exists between the state and federal law regarding transfers subject to the gift tax. As a general rule, any transfer subject to the federal gift tax will also be subject to the Washington gift tax. The Washington statute provides that a tax shall be imposed upon the privilege of transferring property by gift. Only transfers of property (real

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1 Revenue Act of 1932, ch. 209, 47 Stat. 245.
2 One of the exceptions to the general rule is a transfer by power of appointment, to be discussed infra. Another is the transfer of real property to a joint tenancy between husband and wife, also discussed infra.
3 RCW 83.56.030(1).
4 Washington State Tax Commission Regulations Relating to Gift Taxes, Art. 7, provides that "a taxable gift may be effected by the declaration of a trust, by the foregoing of a debt, by the assignment of a judgment, by the assignment of the benefits of a contract of insurance, or the naming of the beneficiary thereof, or the transfer of cash, certificates of deposit, or federal, state, or municipal bonds. Inasmuch
WASHINGTON GIFT TAX

or personal, tangible or intangible) by individuals are subject to the gift tax. The tax is not applicable to transfers by corporations.

A gratuitous transfer of community property to a person other than a member of the community results in two gifts—one by each spouse for one-half of the whole value of the transferred property. The conversion of separate property into community property, no matter how effected, will result in a gift of one-half the value of the separate property.

A "gift" for state and federal tax purposes is not limited to its common law meaning—a transfer of property without consideration. Any "voluntary and complete transfer of property by an individual for less than an adequate and full consideration in money or money's worth, which is not a bona fide business transfer at arm's length," is deemed a "gift."

A taxable gift requires a "complete" transfer of property. The amount of control over the property retained by the donor is the key to the "completeness" of the transfer. The Washington statute provides that a transfer of property in trust where the donor retains the power to vest title in himself, "either alone, or in conjunction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom," is not a taxable gift. The transfer becomes complete upon the relinquishment or termination of the power during the donor's lifetime. Any payment of income therefrom to a beneficiary other than the donor is a taxable gift.

The Washington statute mentions only retention by the donor of a

as the tax is imposed upon gifts indirectly made, all transactions whereby property or property rights or interests are donatively passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax."

If the transfer is by a resident of the state the tax shall not apply to gifts of real or tangible personal property permanently located outside the state of Washington. If the transfer is by a nonresident the tax shall apply only to a transfer of real or tangible personal property permanently located within the state of Washington.

A transfer by gift from a corporation to an individual is treated as a gift from the shareholders of the corporation. See Washington State Tax Commission Regulations Relating to Gift Taxes, Art. 7(a) and Treas. Reg. § 25.2511-1(h) (1) (1958). RCW 83.56.030(2).

RCW 83.56.030(3).

INT. REV. CODE OF 1954, § 2513, affords non-community property states the same tax treatment through the use of the marital deduction.

See Washington Tax Commission Regulations Relating to Gift Taxes, Art. 7(g).


RCW 83.56.030(3). This provision was taken verbatim from § 501(c) of the Revenue Act of 1932, ch. 209, 47 Stat. 245. See Treas. Reg. § 25.2511-2(c) and (e) (1958). The leading federal case supporting this proposition is Burnet v. Guggenheim, 288 U.S. 280 (1933).

RCW 83.56.030(3); Treas. Reg. § 25.2511-2(f) (1958).
power to revest title. However, other retained powers have affected the taxability of gifts under federal case law. In Sanford's Estate v. Comm'r, the settlor, although divesting himself of any power to revoke the trust or to make himself a beneficiary, retained the power to change the beneficiaries. Such a power was held to render the transfer incomplete; hence, no taxable gift resulted upon the creation of the trust. The court emphasized that such a transfer was incomplete and therefore subject to the estate tax. The holding was buttressed by a desire to correlate the gift and estate taxes which were thought to be mutually exclusive. A later case, Smith v. Shaughnessy, rejected this theory. There T made a gift of stock in trust to W for life. Upon the death of W, if T survived, the stock would revert to him. If T predeceased W, the stock went according to W's will or by intestacy to W's heirs. The court stated:

The essence of a gift by trust is the abandonment of control over the property put in trust. The separable interests transferred are not gifts to the extent that power remains to revoke the trust or recapture the property represented by any of them, Burnet v. Guggenheim, supra, or to modify the terms of the arrangement so as to make other dispositions of the property, Sanford v. Commissioner, supra. In the Sanford case the grantor could, by modification of the trust, extinguish the donee's interest at any instant he chose. In cases such as this, where the grantor has neither the form nor substance of control and never will have unless he outlives his wife, we must conclude that he has lost all "economic control" and that the gift is complete except for the value of his reversionary interest.

The test of "completeness" at the federal level, accordingly, "is not whether the transfer is complete under the estate tax, but whether the transferred property has passed beyond the control of the transferor, in the sense that it is no longer subject to his will." Although the Washington statute only mentioned retention of the power to re vest title, it is safe to conclude that no difference exists between federal and state law concerning the effect of the donor's retained control.
A transfer in trust is also rendered incomplete at both levels where the settlor can alter or revoke the trust only with the consent of a person who lacks a substantial adverse interest. However, where the transfer can be altered or revoked by the settlor only with the consent of a person possessing a substantial adverse interest, the transfer is complete and a taxable gift results. A substantial adverse interest is an economically significant interest in a beneficiary which may be prejudiced or extinguished by the exercise of a power to alter or revoke the trust. Any part of the trust which can be altered or revoked without adversely affecting the person required to concur in the exercise of the power is not completely transferred. A taxable gift will result only to the extent of the substantial adverse interest owned by the person whose concurrence is necessary.

The general principles derived from the foregoing federal authorities can be used as a guide to determine the scope of the Washington gift tax law.

**Specific Areas of Difference**

**Joint Interests.** Taxation of joint interests has gained importance as a result of the recent enactment of the Washington joint tenancy statute. A transfer without consideration of separate property to be held in joint tenancy with another will result in a gift of one-half of the value of the property under both state and federal law.

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18 RCW 83.56.030(3); Treas. Reg. § 25.2511-2(e) (1958). A trustee, as such, is not a person having a substantial adverse interest. Ibid. See generally: Latta v. Comm'r, 212 F.2d 164 (3d Cir. 1954), cert. denied, 348 U.S. 825 (1954); Camp v. Comm'r, 195 F.2d 999 (1st Cir. 1952).

19 See generally: Camp v. Comm'r, 195 F.2d 999 (1st Cir. 1952); Higgins v. Comm'rs, 128 F.2d 237 (1st Cir. 1942), cert. denied, 317 U.S. 658 (1942); Comm'r v. Prouty, 115 F.2d 331 (1st Cir. 1940).

20 Cases cited, notes 17 and 18 supra. See also, Comm'r v. Betts, 123 F.2d 534 (7th Cir. 1941). Int. Rev. Code of 1954, § 672(a), for income tax purposes, defines a person possessing an adverse interest "as any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he possesses respecting the trust." A person holding a general power of appointment is deemed to possess a beneficial interest in the trust.

21 For example, if S transfers property in trust to B for life, remainder to R, reserving the power to revoke in conjunction with B, there will be a complete transfer and taxable gift of B's life estate. However, there will not be a completed gift of the remainder because B has no interest adverse to the exercise of the power to revoke the remainder.

22 A more complete discussion can be found in 5 Martens, Law of Federal Gift and Estate Taxation §§ 33.01-34.72 (1959).

23 RCW 64.28. The statute is treated extensively in Joint Tenancy Symposium, 37 Wash. L. Rev. 1-100 (1962).

24 RCW 83.56.030(1); Int. Rev. Code of 1954, § 2511. Treas. Reg. § 25.2511-1(h)(5) (1958), provides that "if A with his own funds purchases property and has the title conveyed to himself and B as joint owners, with rights of survivorship ... but which rights may be defeated by either party severing his interest, there is a gift to B in
The 1954 Code provides special tax treatment for the creation of a joint tenancy in real property between husband and wife. It permits a husband to create a joint tenancy in real property between himself and his spouse without the current payment of any gift tax. The creation of such a joint tenancy is not considered a transfer for federal gift tax purposes. A gift tax is payable only if the tenancy is subsequently terminated by an event other than death. The donor, however, may elect to pay the gift tax upon the initial transfer. Washington lacks such a provision, and would treat it as a transfer subject to the gift tax at the date of transfer.

The federal and Washington gift tax laws provide for similar treatment of joint bank accounts. A transfer of funds into a joint bank account is not a taxable event. Rather, the gift results when the noncontributing party draws upon the account for his own benefit, and it is measured by the amount of the withdrawal.

United States savings bonds payable to co-owners are taxed at the federal level in the same manner as joint bank accounts. Washington law makes no provision for co-owner bonds. The same result is probably obtainable under Washington law by analogy to joint bank accounts.

Powers of Appointment. An important difference exists between

the amount of half the value of the property. The creation of a joint tenancy pursuant to Washington law has the incidents of survivorship and severability required under the foregoing hypothetical. See RCW 64.28.010. A discussion of federal joint interest problems is found in Rudick, Federal Tax Problems Relating to Property Owned in Joint Tenancy and Tenancy by the Entirety, 4 TAX L. REV. 3 (1948). The 1939 federal Code, like the present Washington Act, lacked any explicit provisions for taxing jointly held property. Consequently, the courts resorted to property concepts in order to subject the creation of joint tenancies to the gift tax. See Hopkins v. Magueder, 122 F.2d 603 (4th Cir. 1941); Comm'r v. Logan, 109 F.2d 1014 (3d Cir. 1940); Comm'r v. Hart, 106 F.2d 269 (3d Cir. 1939); Lilly v. Smith, 96 F.2d 341 (7th Cir. 1938), cert. denied, 305 U.S. 604 (1938). See also Stacy, Joint Tenancy and Estate Planning, 37 WASH. L. REV. 44 (1962). Another example of a gift upon the creation of a joint tenancy occurs when a joint tenancy is created and one of the joint tenants contributes more than his proportionate share of the consideration for the property. Then, there is also a gift of the surplus contribution. Rudick, supra.


26 Washington Tax Commission Regulations Relating to Gift Taxes, Art. 7(d), provides: "Where A creates a joint bank account for himself and B, there is a gift to B when he draws upon the account for his own benefit to the extent of the amount drawn." Compare Treas. Reg. § 25.2511-1(h) (4) (1958). Joint bank accounts are treated differently than joint tenancies as long as the depositor retains the power to withdraw his deposit in full. The depositor (donor) by retaining control over the deposit, has made an incomplete transfer. The transfer becomes complete upon a withdrawal by the non-depositor.


28 See Daly v. Pac. Sav. & Loan Ass'n, 154 Wash. 249, 282 Pac. 60 (1949).

federal and Washington law concerning gifts of general powers of appointment. Notwithstanding the possibility that there may be a taxable transfer at the time of the creation of the power,\textsuperscript{30} the federal statute treats the exercise or release of such a power (created after October 21, 1942) as a taxable transfer by the donee.\textsuperscript{31} Washington has no comparable provision, and only the creation of such a power is treated as a taxable transfer under the Washington statute.\textsuperscript{32} Accordingly, under the federal statute two taxable transfers may result; under the Washington statute there is only one.

ILLUSTRATION: In 1961, A transfers property in trust to T. B is designated as the income beneficiary and also is given a general power of appointment over the corpus. In 1962, B dies and exercises the power by will in favor of C. Under the federal law: (1) A is subject to the gift tax in 1961 by virtue of the transfer in trust (\textsc{Int. Rev. Code of 1954} § 2511); (2) B is subject to the gift tax in 1962 by virtue of the testamentary exercise of the power in favor of C. (\textsc{Int. Rev. Code of 1954}, § 2514). Under the state law, A is subject to the gift tax in 1961 because of the creation of the power in conjunction with a disposition of property. It is treated as a gift from A to C. (RCW 83.60.020).

To be taxable under RCW 83.60.020, the creation of a power of appointment must be accompanied by a complete transfer of the property subject to such power.\textsuperscript{33} If the donor retains any control over the property transferred (other than designating the ultimate beneficiaries of the power), the transfer is incomplete and no taxable gift results.\textsuperscript{34}

\textsuperscript{30}If such a power is created in conjunction with a complete and irrevocable transfer of property subject to the power, a taxable gift results. \textsc{Int. Rev. Code of 1954}, § 2511. \textit{Accord}, RCW 83.60.020. See also text accompanying note 37 \textit{infra}. \textsc{Int. Rev. Code of 1954}, § 2514(c), defines a "general power of appointment" as a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

\textsuperscript{31} \textsc{Int. Rev. Code of 1954}, § 2514(b). Note that this section deals only with general powers of appointment. RCW 83.60.020 deals with powers of appointment. Accordingly, special powers are within the purview of the Washington statute.

\textsuperscript{32} RCW 83.60.020 provides that when there is a "gift of a power of appointment, in conjunction with a disposition of property which is effected before or after June 7, 1951, by inter vivos transfer direct or in trust or otherwise," such gift "is subject to the gift tax laws of this state from the donor to the ultimate beneficiary thereof."

\textsuperscript{33} RCW 83.60.010 defines "property" as any property subject to the power of appointment.

\textsuperscript{34} A transfer of property over which the donor retains control is not the subject matter of a completed gift. See text accompanying notes 10-22 \textit{supra}. If property subject to a power of appointment is still within the control of the donor, the power of appointment itself is subject to the control of the donor and has not vested absolutely in the donee.
The Washington gift tax applies without regard to the exercise,\textsuperscript{35} non-exercise, termination, or renunciation of the power. The creation is deemed a transfer subject to the gift tax laws as if it were a gift from the donor to the ultimate beneficiary.\textsuperscript{36} The ultimate beneficiary is "any person who becomes entitled to the property through the exercise of the power, or by reason of nonexercise of the power, or by reason of renouncement of the power by the donee, or by reason of renouncement or waiver by the person appointed to receive the property."\textsuperscript{37}

The Washington tax is due as of the date of the creation of the power. The duty of paying the tax is placed upon any person (including a donee) who holds the property or the title thereto in trust or otherwise.\textsuperscript{38} However, the duty to pay is not to be construed as imposing a personal liability on such a person.\textsuperscript{39} The result, therefore, seems to be that the donor is personally liable. But, on the other hand, the tax may be paid out of the property transferred subject to the power. In essence, this would subject the ultimate beneficiary to the imposition of the tax by reducing the value of his gift to the extent of the tax.

Implementation of the Washington gift tax upon the creation of a power of appointment is impeded by the fact that the amount of the tax imposed is determined by the relationship to the donor of the ultimate beneficiary.\textsuperscript{40} The statute, recognizing that at the time of creation the ultimate beneficiary is unknown, provides that the greatest possible tax is to be paid at the date of the gift.\textsuperscript{41} Such tax is "a tentative tax computed on an assumed devolution of the property to an ultimate beneficiary within the limitations of the power, who would be taxable at the highest rates provided by the gift tax laws of this state."\textsuperscript{42}

In order to relieve from the burden of this provision, alternative methods for payment of the tax have been authorized in lieu of pay-

\textsuperscript{35} If a donee exercises the power by creating another power of appointment in another donee to all or any of the property, such property is taxed as if the second donee is the ultimate beneficiary thereof. RCW 83.60.080.
\textsuperscript{36} RCW 83.60.020.
\textsuperscript{37} RCW 83.60.010.
\textsuperscript{38} RCW 83.60.030.
\textsuperscript{39} RCW 83.60.030.
\textsuperscript{40} See RCW 83.56.040.
\textsuperscript{41} RCW 83.60.050.
\textsuperscript{42} RCW 83.60.010. Example: S transfers Blackacre (worth $10,000) in trust, giving his son a life estate and a power to appoint the remainder to himself or anyone else, with a gift over in default to the son's estate. Although son may appoint himself a beneficiary (Class A), he may appoint to anyone, including a Class C beneficiary. Therefore, the higher Class C tax is due. See RCW 83.56.040.
(1) A surety bond in the amount of the greatest possible tax may be executed in favor of the state of Washington. The surety promises the tax commission that upon the exercise or termination of the power the commission will be notified and the final tax paid in full. (2) The person subject to the duty to pay the tax may elect to pay a tentative tax based upon the probabilities of devolution of the property. He must file a bond for the difference between the tentative tax paid and the greatest possible tax. Generally where the cost (such cost is dependent upon the circumstances of each case) of such bond is less than the donor's rate of return upon the money which would pay the tentative gift tax and he is reasonably sure of the ultimate beneficiary, it will be highly advisable to take advantage of these alternatives, preferably number (1).

If the power is exercised or terminated prior to the procurement of the bond or other security, the donee has the duty to so notify the commission. The notice must include the ultimate beneficiary's name, address and relationship to the donor. Failure to notify may subject the donee to the gift tax liability.

Certain Annuities Under Qualified Plans. The Washington gift tax statute has no provision comparable to section 2517 of the federal code. This provision is an exception to section 2511, the general provision which taxes all transfers by gift. Under the general rule of section 2511, if an employee with an unqualified right to an annuity irrevocably elects to take a lesser annuity with a provision that, upon his death, a survivor annuity will be paid to a designated beneficiary, a gift of the survivor annuity will result. Section 2517, however, provides that where an employee irrevocably names a beneficiary to receive benefits from various employee trusts or from certain retirement-annuity contracts upon the employee's death, that portion of the benefits attributable to the contributions made by the employer is not subject to gift tax. A gift tax is payable on that portion repre-

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48 RCW 83.60.050.
44 Any person, including the donee, who holds the property or the title thereto in trust or otherwise.
45 The tax commission has the discretion to accept in lieu of any bond or payment of the tax any other security which is deemed adequate. RCW 83.60.050. If any tentative tax paid is determined to be in excess of the final tax, a refund of the excess shall be granted by the commissioner, without interest. RCW 83.60.060.
46 RCW 83.60.040.
47 Treas. Reg. § 25.2511-1(h) (10) (1958). See also Treas. Reg. § 25.2517-1(a) (1) (1961) listing three principal ways in which such a gift can be made.
45 See Int. Rev. Code of 1954, § 2517(a) for a list of annuities qualifying for this special gift tax treatment.
sented by contributions of the employee. In the absence of an express statutory provision to the contrary, the normal Washington rules concerning transfers by gift are applicable. State gift tax consequences will be the same as the result under section 2511 of the 1954 Code. 49

**Certain Property Settlements.** Under the Internal Revenue Code of 1939, property settlements between spouses were not regarded as taxable gifts if the property settlement was incorporated in the decree of divorce. 50 The gift tax status of settlements not incorporated in the decree of divorce depended upon the facts of each case.

Section 2516 of the 1954 Code has remedied the uncertainty inherent in the prior federal case law. Incorporation of the separation agreement in the divorce decree need no longer be shown. Transfers made pursuant to a separation agreement are deemed to be transfers made for a full and adequate consideration in money or money’s worth if divorce occurs within two years thereafter.

The Washington statute has no specific provision concerning the taxability of property settlements incident to divorce. As a practical matter, usually no gift question will arise in these circumstances because most of such settlements merely split the community property equally among the parties. However, if such a question were to arise it is unclear whether similar treatment will be given transfers qualifying as non-taxable gifts pursuant to section 2516 of the 1954 Code, or whether they will be handled as they were under the 1939 Code, analyzed in the same light as any other transfer subject to the gift tax. The preferable alternative is to accord such transfers the same treatment as provided by federal law. This will remedy the confusion and

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49 The general provisions of RCW 83.56.030 will be applied to determine if the transfer is subject to taxation. See Washington Tax Commission Regulations Relating to Gift Taxes, Art. 7(b), providing that “the transfer of property to B where there is imposed upon B the obligation of paying a commensurate annuity to C would constitute a gift to C.”

50 Harris v. Comm'r, 340 U.S. 106 (1950). In this case H and W, preliminary to divorce proceedings, entered into a property settlement agreement. The value of the property transferred to H exceeded that received by W by over $100,000. The agreement provided that it should be submitted to the divorce court “for its approval.” It also provided that “the covenants in this agreement shall survive any decree of divorce which may be entered.” The divorce decree provided that “said agreement and said trust agreements forming a part thereof shall survive this decree.” The Supreme Court held that the transfers were founded upon the divorce decree and were not, therefore, subject to the gift tax. Accord: McMurtry v. Comm'r, 203 F.2d 659 (1st Cir. 1953).

Provisions for support and maintenance have been treated differently. An award pursuant to a divorce decree incorporating a child support settlement has resulted in a taxable gift in an amount equal to the excess beyond the child’s needs. See Rosenthal v. Comm'r, 203 F.2d 585 (2d Cir. 1953); Hooker v. Comm'r, 174 F.2d 853 (5th Cir. 1949).
uncertainty inherent in this area and will avoid further conflict with the federal law.

Annual Exclusion. Both Washington and federal law provide an annual exclusion permitting a donor to make a $3,000 gift per donee without incurring gift tax liability. A $6,000 tax-free gift of community property can be made because it is deemed to be a gift by each spouse of one-half of the whole value of the property transferred. Generally, a gift which qualifies for the annual exclusion under federal law will also qualify for the state exclusion.

The exclusion is not applicable to gifts of “future interests.” A leading federal case, Fondren v. Comm’r, defines the term “future interest” as follows:

[I]t is not enough to bring the exclusion into force that the donee has vested rights. In addition he must have the right presently to use, possess or enjoy the property. These terms are not words of art like “fee” in the law of seizin, . . . but connote the right to substantial present economic benefit. The question is of time, not when title vests, but when enjoyment begins. Whatever puts the barrier of a substantial period between the will of the beneficiary or donee now to enjoy what has been given him and that enjoyment makes the gift one of a future interest within the meaning of the regulation.

The test of whether an interest is present or future, according to the Fondren case, is whether the donee has a right to immediate possession or enjoyment of the transferred property. Application of the “future interest” rule is illustrated by this example: If S transfers property to T in trust for B, with directions to accumulate the income from the property for ten years and then to pay over the corpus and accumulated income to B, with a gift over to B’s estate if B dies within the ten year period, B receives a future interest. Note that the donee of a gift in trust is the trust beneficiary rather than the trustee.
Three problems in relation to the annual exclusion exist at both state and federal levels. The first problem concerns whether a corporation can be treated as the donee of a gift. Neither act expressly precludes the possibility of a gift to a corporation. Unlike a trust, a corporation is recognized as a separate legal entity. However, both laws recognize that a gift made by a corporation is deemed to be made by its shareholders. Logically, the corporate entity should be disregarded also in the case of a gift to a corporation, and the gifts treated as gifts to the shareholders. A gift to a corporation normally results in the enhancement of the value of the shareholders' interest with resultant benefit to the shareholders who are the actual owners of the corporation. In this respect, a gift to a corporation is analogous to a gift in trust. Nevertheless, in several cases, the Federal Tax Court has held that a gift to a corporation is a gift to the corporate entity itself rather than to its shareholders. The inference arising from the classification of a corporation as a Class C donee in the Washington statute lends support to this proposition. Although the law in this area is ambiguous and inconsistent, it appears that a transfer to a corporation under circumstances evidencing an intent to make the corporate entity the donee will be treated as a gift to the corporation at both state and federal levels.

The second problem concerns whether a transfer to a corporation is a gift of a future interest. The Washington statute provides that a gift to a corporation may be eligible for the annual exclusion. The federal statute does not expressly classify gifts to corporations as eligible for the exclusion. The term "any person" appearing in section 2503(b), however, if construed in its broadest sense, would

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59 RCW 83.56.040 expressly includes corporations within Class C donees.


61 Treas. Reg. § 25.2511-1(h)(1) (1958), provides that "a transfer of property by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation." (Emphasis added.)


63 RCW 83.56.040.

64 RCW 83.56.050.

65 INT. REV. CODE OF 1954, § 2503(b).
include corporations. Where a gift is deemed made to the corporate entity itself, the donor is entitled to one annual exclusion. If the gift is treated as a gift to the shareholders the "future interest" problem arises. In *Heringer v. Comm'r*, the Ninth Circuit court of appeals held that a gift to a corporation, if treated as a gift to the shareholders, would not be eligible for the annual exclusion. The court reasoned that the shareholders could derive possession or enjoyment of the transferred property only upon the declaration of a dividend. Clearly, as to the shareholders, this is "an interest limited to commence in possession or enjoyment at a future date." Note that if the gift is treated as a gift of a present interest to the shareholders, the donor is allowed an annual exclusion for each shareholder donee. However, in light of the reasoning in the *Heringer* case, a donor who successfully establishes that the individual shareholders are his donees rather than the corporate entity, will nevertheless not qualify for multiple annual exclusions. Apparently Washington will follow the *Heringer* decision because the "future interest" concept is viewed similarly. However, a persuasive argument can be made in favor of a "present interest" under the *Heringer* facts. The court assumes that a shareholder could only enjoy the benefit of such transferred property upon the declaration of a dividend. This assumption may not be warranted. Since the transfer will increase the value of the stock, a shareholder could realize his share of the benefit by selling his stock. No prior action need be taken by the corporation to effect realization of such a benefit. Accordingly, as long as a shareholder has the present right to sell his stock, he necessarily has the present right to enjoy his share of the benefit from the transferred property. The only flaw in the foregoing analysis is that most gifts to corporation and shareholder problems arise in the closely-held corporations where no readily available market exists for such stock.

The third problem relating to the annual exclusion involves gifts to minors. An outright unrestricted gift to a minor would be a gift of a present interest. Ordinarily, however, the donor wishes to restrict the gift in a way that will assure proper management and use. The donor either transfers the property in trust or to a guardian, accompanied by restrictions limiting the present use and enjoyment of the property by the minor-donee.

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66 Mertens, *op. cit. supra* note 22, at § 38.25. See also, federal cases cited note 62 *supra*.

67 235 F.2d 149 (9th Cir. 1956). This result is criticized in Lowndes and Kramer, *op. cit. supra* note 10 at 582.
Section 2503(c) of the 1954 Code provides that a gift to a minor meeting certain requirements qualifies for the annual exclusion despite its in futuro nature. Section 2503(c) provides:

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 the 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 as he may appoint under a general power of appointment as defined in section 2514(c).

A gift to a minor meeting the foregoing requirements is deemed a present interest and qualifies for the annual exclusion. Example: $ transfers property in trust to $ with income payable to $, his minor daughter. $ gives $ discretionary power to accumulate income or invade corpus for the benefit of $ . Corpus and accumulated income pass to $ at age 21 or to her estate if she dies before majority. $ transfers $3000 to the trust annually. These transfers qualify for the federal annual exclusion. However, Washington has no comparable provision. Therefore, since $ has the power to accumulate income, $ does not have an unrestricted right to possession or enjoyment and the annual exclusion is not available for Washington gift tax purposes.

In order to avoid such a result the Washington lawyer, in the absence of corrective legislation, must draft a trust instrument which will qualify for the annual exclusion. Two federal cases, Kieckhefer v. Comm’r and Stijel v. Comm’r, reaching different conclusions upon substantially the same facts, have added to the uncertainty inherent in this area. The question presented in each case was whether or not a transfer in trust with the following termination provision constituted a present interest:

The beneficiary shall be entitled to all or any part of the trust estate or to terminate the trust estate in whole or in part at any time whenever said [minor donee] or the legally appointed guardian for his estate shall make due demand therefor by instrument in writing, filed with the then trustee and upon such demand being received by the trustee the trustee shall pay said trust estate and its accumulations, or

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68 See Wright, Gifts to Minor Children—Guardianship vs. Inter Vivos Trusts—Is the Kieckhefer Trust the Answer? 27 WASH. L. REV. 1 (1952).
69 189 F.2d 118 (7th Cir. 1951).
70 197 F.2d 107 (2d Cir. 1952).
the part thereof for which demands made, over to said [minor donee] or to the legally appointed guardian for his estate who made such demand on his behalf. (Emphasis added.)

In *Kieckhefer*, the trust provision created a present interest. The settlor had given the minor beneficiary the fullest rights of possession and enjoyment consistent with the disabilities of infancy. The court looked solely at the trust instrument to determine if the right to present enjoyment or possession was conferred by the instrument. The fact that a minor donee is subject to an extrinsic legal disability which prevents him from terminating the trust effectively was not taken into consideration.

However, in *Stifel*, the court held that the extrinsic factor of legal disability must be taken into consideration. Since the legal guardian had not yet been appointed, no one could terminate the trust, and the minor donee's right to possess or enjoy the trust property was postponed. Therefore, the court found a future interest.

A recent Washington attorney general's opinion concludes that the *Kieckhefer* decision "is the preferable result and within the intended area of exclusion established by the legislature." Presumably, a transfer to a Kieckhefer-type trust will be deemed a present interest qualifying for the annual exclusion granted by RCW 84.56.050. Note that the Kieckhefer-type trust qualified as a present interest within the requirements of section 2503(c) of the 1954 Code. Accordingly, a transfer in trust which meets the requirements of section 2503(c) probably will be treated as a present interest for the purposes of RCW 83.56.050.

The Uniform Gifts to Minors Act provides the donor with another method of transferring present interests to a minor. This Act allows an adult to make a gift of a security or money to a minor as long as...
such security or money is held by a custodian for the benefit of the minor. However, the utility of the Act is restricted by several limitations. Only gifts of securities or money may be made. The amount of the gift is limited to $3,000 per minor donee per year. Suppose F transfers separate property consisting of securities worth $5,000 to X, an adult, as custodian for S, F's minor son. Is $3,000 worth of the securities treated as custodial property subject to the provisions of the Act? A close reading of RCW 21.24.020(4)(a) requires a negative answer.

Also, a donor may not make gifts of custodial property exceeding thirty thousand dollars in aggregate to any one minor. The advantage of qualifying a gift under the Uniform Gifts to Minors Act is that such a gift is deemed irrevocable and conveys to the minor indefeasibly vested legal title to the security or money transferred. The transfer qualifies for the annual exclusion because the donee has received an "unrestricted" present right to possession or enjoyment of the gift. The donor, at the same time, is assured that the transferred property will be properly administered, the Act vesting the custodian with certain rights and duties. In essence, the custodian has the same discretionary powers as the trustee of a trust which qualifies under section 2503(c) of the 1954 Code.

Specific Exemption. A lifetime exemption of $30,000 is available to the donor under the federal gift tax law. Washington allows a maximum lifetime exemption of no more than $11,000.

The federal exemption applies to any transfer by gift to any donee. Application of the Washington exemption is limited by the donor-donee relationship. The statute divides the donees into classes according to

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76 The manner of making a gift to a minor pursuant to the Uniform Gifts to Minors Act is set out in RCW 21.24.020 as follows: "(1) An adult person may, during his lifetime, make a gift of a security or money to a person who is a minor on the date of the gift: (a) If the subject of the gift is a security in registered form, by registering it in the name of the donor, another adult person, or a trust company, followed, in substance, by the words: 'As custodian for (name of minor) under the Washington Uniform Gifts to Minors Act'; (b) if the subject of the gift is a security not in registered form, by delivering it to a trust company or an adult person other than the donor, accompanied by a statement of gift . . . . Security is defined in RCW 21.24.010(2).

77 RCW 21.24.020(4)(a). Six thousand dollars worth of community securities may be transferred. See RCW 83.56.030(2). The original uniform act has no such dollar limitation. See § 2 Uniform Gifts to Minors Act 9B Uniform Laws Annotated 183 (1957).


79 RCW 21.24.030(1).

80 See RCW 21.24.040.

their relationship—an exemption of $10,000 is allowed for gifts to Class A; 82 $1,000 for Class B gifts; 83 and no exemption is allowed for Class C gifts. 84

The federal gift tax is computed upon the amount of taxable gifts less deductions, which include the $30,000 exemption. 85 Therefore, the specific exemption may be used to reduce the amount of taxable gifts, placing the donor in lower federal gift tax brackets. The Washington lifetime exemption will not place the taxpayer in a lower tax bracket. This is because the exemption is merely offset against the lowest-bracket gifts, 86 and does not reduce the aggregate amount of gifts, which is the basis for imposition of the gift tax. 87

ILLUSTRATION: (Assuming that A has never before used any of his lifetime exemption): A, a bachelor, transfers $38,000 worth of stock by gift to B, his sister. A is subject to federal gift tax liability on a taxable gift of $5,000 ($38,000 less $30,000 lifetime exemption and $3,000 annual exclusion). This puts him in the lowest federal gift tax bracket (2 3/4%). However, A is subject to Washington gift tax liability on a net gift of $35,000 ($38,000 less $3,000 annual exclusion). The lifetime exemption of $1,000 for Class B gifts is set off against $1,000 of the net gift in the lowest tax bracket. Consequently, A is subject to tax upon $4,000 of net gifts in the 2.7% (90% of 3%) tax bracket, $5,000 of net gifts in the 3.6% (90% of 4%) tax bracket, $20,000 of net gifts in the 6.3% (90% of 7%) tax bracket, and $5,000 of net gifts in the 9% (90% of 10%) tax bracket.

Computation of Tax. Another significant difference between state and federal gift taxation concerns the effective dates of the laws. Both laws are computed on the aggregate amount of taxable gifts. However, the federal tax aggregates such gifts from June 6, 1932 88 and the Washington tax aggregates such gifts from March 21, 1941. 89 Therefore, a current gift may be added to a higher aggregate of gifts for federal tax purposes than for state purposes. Also, the specific federal

82 Class A donees include: lineal ancestors, lineal descendants, husband, wife, step-child or lineal descendant of a stepchild, adopted child or lineal descendant of an adopted child, adopted child of the lineal descendant of the donor, son-in-law, or daughter-in-law. RCW 83.56.040.
83 Class B donees include brothers or sisters. RCW 83.56.040.
84 Class C donees include any other person not mentioned in Class A or B. RCW 83.56.040.
86 See RCW 83.56.040.
87 See RCW 83.56.040, 050.
89 RCW 83.56.040 and RCW 8.56.005.
lifetime exemption may have been expended over the longer accumulation period, while the state exemption may still be available.

Charitable or Similar Gifts. Several differences exist between the Washington and federal acts which may cause problems in determining the amount of the "charitable" deduction allowed by RCW 83.56.060 and section 2522 of the 1954 Code.

(a) The state law allows a nonresident the same deductions as a resident. The federal law has a specific provision for nonresident deductions.

(b) The federal law allows a deduction for gifts made to the United States, any State, Territory, or any political subdivision thereof, for exclusively public purposes. Under the Washington statute, only gifts to the United States or the state of Washington are deductible. An exclusive public purpose is not expressly required to qualify the gift in Washington.

(c) A gift to a corporation, trust, etc., otherwise qualifying for the deduction, is not deductible under federal law if a substantial part of its activities concern carrying on propaganda or otherwise attempting to influence legislation. No such limitation exists under the Washington Act.

(d) The Washington Act has no provision comparable to the federal provision which allows a deduction for a gift to "posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations."
(e) Encouragement of art and the prevention of cruelty to children or animals is included within the purposes of qualified organizations under the federal provision. Washington lacks a similar provision.

Gifts to Spouse (Marital Deduction). The Federal Code allows the donor a deduction equal to one-half the value of any property interest transferred by gift to his spouse. This deduction is allowed in order to provide equality of tax treatment for residents of non-community property states. It extends to such persons the "splitting" process formerly enjoyed only by residents of community property states, and does not apply where the donor's interest in community property is transferred to his spouse.

Washington has no similar provision. A gift of the donor's separate property to his spouse, to be held as her separate property, will be taxable to the full amount of the gift.

CONCLUSION

This comment has demonstrated several areas in which different tax consequences result at the state and federal levels. The differences are not justifiable and have resulted primarily from failure to revise and modernize the Washington gift tax statute. The ideal gift tax statute would be one producing the same gift tax consequences at both state and federal levels. Administration of the gift tax would then be greatly facilitated. Federal rulings, regulations and cases would be more persuasive, increasing the certainty of the state law. In the absence of such revision, the Washington lawyer must keep the various distinctions in mind. It is easy to overlook the Washington gift tax aspects of a given transfer when the federal tax is uppermost in mind.

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