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QUALIFYING GIFTS OF FRACTIONAL SHARES OF ILLINOIS LAND TRUSTS FOR THE PRESENT INTEREST EXCLUSION

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INTRODUCTION

For too long it has been assumed by practitioners and authors alike that transfers of fractional shares in the beneficial interest of Illinois land trusts could be made to maximize the $3,000 present interest gift tax exclusion codified in section 2503(b) of the Internal Revenue Code, while retaining the greatest benefits for the donor/client. Although case precedent is scarce, a 1979 Court of Claims decision raised new concern among proponents of such gift giving.

In McClure v. United States, the court held that gifts of fractional shares of the beneficial interest in a land trust did not

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1. All section references in this paper are to the Internal Revenue Code of 1954, as amended. I.R.C. § 2503(b) provides in part:

   In computing taxable gifts for the calendar quarter, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1971 and subsequent calendar years, $3,000 of such gifts to such person less the aggregate of the amounts of such gifts to such person during all preceding quarters of the calendar year shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such quarter.

   Recently, the Economic Recovery Tax Bill of 1981, Pub. L. No. 97-34 (to be codified in scattered sections of 26 U.S.C.) has changed various sections of the Internal Revenue Code. Section 441(a) of the Act increases the exclusion under I.R.C. 2503(b) to $10,000 per donee to transfers made after December 31, 1981. Also, under section 441(b) of the Act, Congress has added a new section, 2503(e) which allows unlimited transfer of property for certain medical care payments or educational expenses.

   The Economic Recovery Tax Bill of 1981 was enacted after this issue went to press. For this reason, all other references to the Internal Revenue Code of 1954 should be read in light of the new act.


4. Id. at 479.
qualify as present interest gifts subject to the section 2503(b) annual exclusion. McClure necessitates a review of the assumptions underlying such a gift-giving plan and the pitfalls which may be presented to the donor. This article will discuss the benefits and detriments of such plans and focus on the implications of the McClure decision.

DEFINITION OF TERMS

The Illinois land trust remains a unique entity, in spite of assertions that most other states have adopted the view which upholds such trusts. The typical Illinois land trust refers to a simple title holding arrangement whereby both legal and equitable title to a parcel of realty are conveyed to a trustee whose only active duty under the agreement is to sell the trust res upon the expiration of twenty years and distribute the proceeds among the beneficiaries. Under the typical land trust agreement, the interest of the beneficiary is transmuted from a real property interest to a personal property interest in the possession, rents, proceeds, and avails of the trust res. The beneficiary has the power to direct the trustee in writing to convey title and to execute documents affecting title, both legal and equitable.

The transmutation of realty into personalty is one reason why fractional interest gifts of the beneficial interest are attractive. Ownership of personalty can be transferred without the necessity of public recordation by the mere execution of an instrument of assignment lodged with the trustee. Thus, a gift of the beneficial interest in a land trust is both simple and confidential. Due to the nature of the interest, a gift may be made of


An informal survey of other states revealed that unlike Illinois, where the land trust agreement used by major trust companies has become almost standardized, these states have not adopted such a uniform trust agreement. Thus, this article will focus on the standard agreement used in Illinois and will not attempt to explore all possible variations.

6. Hereinafter referred to as “the land trust.”


a fractional share without dividing the trust res. Therefore, it is possible to assign a fractional share in the beneficial interest in a land trust equal to or less than $3,000 in fair market value at the time of the gift. This can be done without public knowledge of the transfer, without incurring any gift tax liability, without actually physically dividing the real estate which is the trust res, and without actually relinquishing dominion, control, and enjoyment of the res by the donor.10

**ANALOGOUS SITUATIONS**

When the issue of how a particular transaction or entity should be taxed arises,11 the Internal Revenue Service (IRS) has established the principal that substance rather than form is controlling. Keeping with this principal, the IRS has developed guidelines for taxation of certain land trust arrangements as either individual, partnership, or corporate entities rather than as other trusts.12 Thus, it is useful in analyzing the substance of gifts of fractional shares in land trusts to make a comparative analysis of gifts of other types of personalty.

One analogy to gifts of other personal property is that of a gift of a minority block of capital stock in a closely held corporation by the holder of the majority interest. The donor transfers outright a small block of stock having a fair market value of $3,000 or less at the time of the gift without actually parting with dominion and control over the corporation, without transferring the actual property and assets of the corporation, without transferring an absolute right to present income, and without paying any gift tax.13 The donee, however, has received a potentially valuable piece of personalty, a potential right to the profits of the corporation, a right to vote on corporate matters, a right in the corporate property or the proceeds thereof upon liquidation, and a fully transferable (albeit not necessarily marketable) interest.

11. See, e.g., Laura M. Hutchinson, 47 T.C. 680, 686 (1967) which held: "We are not bound over to a tyranny of labels. 'Mere forms of instruments, of course, and the use of words "trust" and "trustee" cannot be depended upon in determining whether or not a trust is in reality created. The transaction itself must be scrutinized.'"
13. But see Chanin v. United States, 393 F.2d 972 (Ct. Cl. 1968) (intrafamily gifts of minority blocks of corporate stocks were gifts of future interests due to the inability of the minority stockholders to directly control the declaration of dividends, the management of the corporation, and the disposition upon liquidation). Such a transfer may present certain valuation problems. For a discussion of these problems see notes 65-74 and accompanying text *infra*. 
Similarly, the assignee of a minority fraction of the beneficial interest in a land trust receives a right to the income, a theoretical right to possession of the realty, a mathematically determinable share in the proceeds of sale, and a vote in the conduct of the business of managing the trust res.

Several other ownership forms of both realty and personalty illustrate how a donor may part with a partial interest without giving away the whole and still qualify for the annual exclusion. For example, consider a gift of a fractional life estate in a living trust where the trust res is rental property, the donor retains a life interest, and the donee life tenant is to receive only a portion of the income for life. Taken a step further, the donee may receive a right in the income for a proscribed period or until the occurrence of a specified event, at which time the trustee is directed to sell the trust res and divide the proceeds among several beneficiaries, one of whom may or may not be the grantor.

Likewise, gifts of partnership interests, joint venture interests, or even joint interests in realty in which the donor retains a larger proportion of the property or right in property than the donee may qualify for the annual exclusion. What then is the critical difference in gifts of fractional shares of the beneficial interest in a land trust? Is the controlling issue whether the type of property transferred is income producing or growth oriented, or is the issue what rights does the donor part with and the donee receive? Is the distinction really form versus substance?

Perhaps the controlling reason for the McClure attack on gifts of fractional shares in the beneficial interest of a land trust is that the benefits to the parties, both donee and donor, far exceed their justification. The assumption underlying section 2503(b) is that to exclude $3,000 worth of gifts to an individual obviates the necessity of filing gift tax returns for such items as Christmas, birthday, and wedding gifts which are made annually by virtually every American. It strains logical reasoning to assume that the same statutory exclusion was envisioned as a means of giving away an entire parcel of real estate tax free.

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15. The trend in gift taxation has been toward the restriction of gift tax benefits as exemplified by the reduction in the annual exclusion from $5000 to $3000 and the elimination of the $30,000 lifetime exclusion. But see the Economic Recovery Tax Bill of 1981, Pub. L. No. 97-34 (to be codified in scattered sections of 26 U.S.C.) which has increased the exclusion to $10,000.

Thus, the *McClure* court was compelled to plug the loophole with the rationale commonly used by the courts in this area: such gifts do not qualify because they are not present interest gifts.\(^{17}\)

**MCCLURE V. UNITED STATES**

*McClure* involved a dispute between the IRS and a widow in both her personal capacity and her capacity as an executor.\(^ {18}\) The dispute concerned the application of the section 2503(b) annual exclusion to the joint transfers by her husband and herself of beneficial interests in a Florida land trust.\(^ {19}\) The IRS had assessed gift tax deficiencies for the transfers, made on two occasions to eleven family members, of 330/1260 of the beneficial interest in a land trust consisting of 1260 acres of Florida realty. The donors jointly retained over fifty percent of the beneficial interest.\(^ {20}\) The transferors filed suit seeking a refund and the Court of Claims held that the transfers did not qualify as “present interest” gifts. Thus, the fractional shares did not fall within the ambit of the section 2503(b) exclusion.\(^ {21}\)

The Court of Claims focused on the salient provisions of the trust agreement which would limit the court’s reasoning if applied to the Illinois land trust.\(^ {22}\) In this agreement, there was the usual language limiting the trustee’s duty of management and control of the property and vesting it in the beneficiaries, along with the rights to receive “rents, earnings, avails, and proceeds thereof.”\(^ {23}\) The beneficiaries’ rights were proclaimed “personalty” only, and the right to partition was expressly denied.\(^ {24}\)

The power of written direction to deal with legal and equitable title to the property was reserved to the holders of a majority of the interest or to such person or persons appointed by the majority in writing.\(^ {25}\) An additional power held by the majority was the power to appoint an administrator to manage the property, collect the rents, pay the liabilities, furnish accounting and tax information, and even reinvest net income or distribute it proportionately to the beneficiaries according to what was

\(^{17}\) McClure v. United States, 608 F.2d 478, 484 (Ct. Cl. 1979).

\(^{18}\) *Id.* at 479.

\(^{19}\) *Id.*

\(^{20}\) *Id.* at 479-80.

\(^{21}\) *Id.* at 479.

\(^{22}\) *Id.* at 480-82.

\(^{23}\) *Id.* at 480.

\(^{24}\) *Id.* See note 62 and accompanying text *infra*.

\(^{25}\) *Id.* at 481.
deemed to be in their best interests.\textsuperscript{26} A successor trustee could also be appointed by the majority or the holder of the power of direction. If there was a failure to appoint a successor trustee, the instrument provided that the trustee might dissolve the trust by conveying title to the beneficiaries.\textsuperscript{27} Finally, although the trustee had the active duty to sell any property remaining in trust after twenty years from the date of agreement, the majority retained the power to extend the terms of the trust an additional twenty years or amend the trust agreement.\textsuperscript{28} The power to amend was subject only to the minorities' right to sell their interest. The majority also retained the right to first refuse the purchase price fixed by the donor at the time of the original assignment.\textsuperscript{29}

The taxpayers filed quarterly gift tax returns for the disputed periods, claiming the section 2503(b) exemption for each transfer to a family member.\textsuperscript{30} Each share in the beneficial interest was valued at $300. The valuation was based on the fair market value of each acre transferred to the trust at the time of the transfer.\textsuperscript{31} The IRS not only disallowed the exclusions as nonqualifying future interests but also revalued the realty at $400 per acre.\textsuperscript{32}

The \textit{McClure} court reviewed the case precedent defining “future interests” for the purpose of section 2503,\textsuperscript{33} and then pinpointed the provisions of the trust agreement which “postponed the donees' right to enjoy the fruits of their gifts...”\textsuperscript{34} The court stressed that under the agreement the minority had no right, absent the consent of the majority, to realize the proceeds of the corpus, and termed such majority consent a “contingency that might never happen” until the expiration of the trust

\textsuperscript{26} Id.
\textsuperscript{27} Id. at 481-82.
\textsuperscript{28} Id.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Id.
\textsuperscript{33} Id. The Court found that while the Internal Revenue Code does not define “future interest,” the term is defined in Treas. Reg. § 25.2503-3(a) (1980) which provides that “future interests” are “interests or estates... which are limited to commence in use, possession, or enjoyment at some future date or time.” See Commissioner v. Disston, 325 U.S. 442, 446 (1945) (gifts in trust to minors until reaching age 21 are gifts of future interests); Fondren v. Commissioner, 324 U.S. 18, 20 (1945) (gifts in trust to minors with distribution at ages 25, 30 and 35 are gifts of future interests). Ryerson v. United States, 312 U.S. 405, 409 (1941) (gifts of separate equal shares of trust corpus in the event of a joint request to terminate trust is gift of future interest.) But see I.R.C. § 2503(c).
\textsuperscript{34} McClure v. United States, 608 F.2d 478, 483-84 (Ct. Cl. 1979).
term. The majority control of the disposition of the income via the power to appoint the administrator was discussed. The court stated that the only present right the minority had was the right to further transfer their interests.

**McClure Distinguished**

The gift-giving plan in McClure failed due to several shortcomings in the trust agreement. Before distinguishing the McClure plan from others, however, it is important to point out several errors in logic the McClure court made which might overly restrict the section 2503(b) exclusion.

The McClure agreement failed in two important respects: (1) it allowed for no absolute right of a minority beneficiary to the income from the corpus, and (2) it allowed the donor effectively to retain a general power of appointment over the corpus. Both of these shortcomings can be remedied by properly structuring such gifts. McClure, however, seemed to indicate that the transfer of an unrestricted right to the immediate use, possession, and enjoyment of the actual corpus is essential to a qualifying gift. If this is true, then even outright gifts of

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35. Id. at 483, originally cited in Ryerson v. United States, 312 U.S. 405, 408 (1941). The court first stressed that the time of distribution of the corpus was delayed. It is not clear why postponement, or even denial, or enjoyment of corpus alone "earmarks the gift as a future interest." See also Commissioner v. Brandegee, 123 F.2d 58 (1st Cir. 1941).


37. Id. at 483-84.

38. See also Hutchings-Sealy Nat'l Bank of Galveston v. Commissioner, 141 F.2d 422 (5th Cir. 1944) (while income belonged to beneficiaries, only trustees could decide when use and enjoyment would begin); French v. Commissioner, 138 F.2d 254 (6th Cir. 1943) (since trustee had discretion to distribute or accumulate income, the income was a gift of a future interest); Commissioner v. Phillips' Estate, 126 F.2d 851 (5th Cir. 1942) (beneficiaries could not receive income except at discretion of trustees until death of trustee or expiration of ten years). But see I.R.C. § 2503(c) which 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 or as he may appoint under a general power of appointment as defined in section 2514(c).


corporate stock, bond indentures, real estate subject to a leasehold, and a life tenancy in a living trust would not qualify.41

The Illinois land trust avoids the pitfalls present in the McClure trust agreement. An Illinois land trust provides for an absolute right of the beneficiary in the rents, avails, and proceeds of the corpus and omits such provisions as the power of the majority to appoint an administrator to collect and control the income, the right of first refusal upon sale by the minority of their respective shares, and the right of the majority to extend the trust term an additional twenty years. Essential to an understanding of what further provisions in the land trust agreement are necessary to qualify such gifts is a review of the fundamentals of a completed gift and the line of cases defining present versus future interests.

PRESENT V. FUTURE INTEREST

The academic elements of a completed gift are donative intent, delivery, and acceptance. In a typical gift by assignment arrangement, acceptance is not an issue because the usual assignment of beneficial interest form provides for the signature of the donee as acceptance of the gift subject to the terms of the trust agreement. Likewise, donative intent typically is not an issue since the Internal Revenue Code has eliminated the state of mind of the donor as a test for a completed gift and substituted the “less than adequate and full consideration test.”42 The critical issue in gifts of the beneficial interest in a land trust is delivery. In other words, has the donor parted with enough dominion and control over the property to have passed a present interest to the donee.

The Internal Revenue Code does not define “present interest”43 or “future interest.”44 Thus, courts and authors have had a difficult time applying these terms to section 2503(b).45 By re-

41. See notes 11-14 and accompanying text supra.
43. “Present interest” is defined, however, in Treas. Reg. § 25.2503-3(a). See note 53 infra.
45. See Commissioner v. Disston, 325 U.S. 442, 446 (1945); Fondren v. Commissioner, 324 U.S. 18, 20 (1945); Ryerson v. United States, 312 U.S. 405, 409 (1941); United States v. Pelzer, 312 U.S. 399, 403 (1941); Commissioner v. Taylor, 122 F.2d 714, 716 (3d Cir. 1941); Hopkins v. Magruder, 122 F.2d 693, 696 (4th Cir. 1941); Welch v. Paine, 120 F.2d 141, 143 (1st Cir. 1941); Annot., 158 A.L.R. 171 (1945); Comment, The “Future Interest” Exception to the Annual Exclusion in Section 2503(b): A Proposed Amendment, 52 Nw. U.L. Rev. 135 (1957).
lying on phrases like "present power of possession and enjoyment,"46 "right presently to use, possess, and enjoy,"47 and "unrestricted right to immediate use, possession, or enjoyment,"48 courts have merely parroted the Regulations.49 Indeed, the beneficial interest under most land trust agreements includes the right to use, possess, or enjoy the realty. Yet the issue is more complex: when does the donee actually receive the rights, and which rights actually have value for gift tax purposes?

The effect of postponement of enjoyment of rights has been dealt with in many forums.50 It is clear that the time of vesting of rights is not a controlling factor; a fully vested remainder is unquestionably a future interest.51 Thus, it has been held that the mere "postponement of enjoyment of specific rights, powers or privileges" may disqualify a gift as a present interest.52 Also, the interposition of contingencies which must occur before enjoyment has disqualified gifts,53 even though the donor has parted with all dominion and control of all benefit to himself.54

Courts have also examined the nature of the property conveyed as a factor in the ultimate determination. Thus, the question may turn on whether or not the subject of the gift is income producing, or has a current market value. At least one court has held the controlling question to be whether the donee has the right to the income regardless of whether the property is actually income producing property.55

46. Heringer v. Commissioner, 235 F.2d 149, 152 (9th Cir. 1956).
47. Gilmore v. Commissioner, 213 F.2d 520, 521 (6th Cir. 1954).
49. For the purpose of I.R.C. § 2503(b), "future interest" is defined in Treas. Reg. § 25.2503-3(a) as "a legal term, and includes . . . interests or estates . . . limited to commence in use, possession, or enjoyment at some future date or time. [A] future interest . . . may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift."

A "present interest" is defined in Treas. Reg. § 25.2503-3(b) as "[a]n unrestricted right to the immediate use, possession, or enjoyment of property . . . ."

50. See notes 50-52 supra.
51. See Treas. Reg. § 25.2503-3(a); see also Fondren v. Commissioner, 324 U.S. 18, 20 (1945).
52. Jacob W. Blasdel v. Commissioner, 58 T.C. 1014, 1017 (1972), aff'd, 478 F.2d 226 (5th Cir. 1973) quoting Commissioner v. Gloss, 123 F.2d 548, 550 (7th Cir. 1941).
53. Id. at 1018-19.
The mere right to assign, alienate, or otherwise dispose of the subject has been clearly overruled as a controlling factor, the rationale being that even a future interest may be marketable. The court in *Heringer v. Commissioner* stated that if the test were marketability the statutory purpose of the restrictive language in section 2503(b) would be defeated. Yet it is perhaps the very issue of how to value the mere right to alienate, assign, or otherwise dispose of rights in futuro that led Congress to exclude such interests from the exemption.

To summarize, for a gift to qualify for section 2503(b) treatment it must be a gift of immediately realizable value such as an immediate right to income, possession, use, or enjoyment. With the exception of section 2503(c) gifts to minors, there can be neither postponement of enjoyment nor contingencies which must occur prior to enjoyment or which might cut off enjoyment making valuation speculative. The right to alienate alone is not sufficient, nor is vesting sufficient to qualify a gift. It is what the donee receives and not what the donor parts with that is controlling. With these limitations in mind, an examination of what the donee of the beneficial interest in a land trust receives is in order.

**STRUCTURING THE GIFT**

First, consider the donee of 100 percent of the beneficial interest. As sole beneficiary under the standard agreement, the donee has a personal property right to the earnings, avails and proceeds of the real estate which is the trust res. The beneficiary has the right to manage, control, and possess the property, and the right to transfer his interest. Unless the trust agreement provides otherwise, the beneficiary also has the power to direct the trustee to deal with title to the property. Clearly, a gift of 100 percent of the beneficial interest is a gift of all the incidents of ownership necessary to qualify for the section 2503(b) exclusion.

Likewise, a gift to a sole beneficiary donee with provision for a survivor beneficiary should qualify for the exclusion. The contingent remainder to the survivor would, of course, be disqualified for it is a future interest. However, even a life estate in the

56. See *Chanin v. United States*, 393 F.2d 972, 977 (Ct. Cl. 1968).
57. 235 F.2d 149 (9th Cir. 1956).
59. See note 38 supra. The exception may, however, be of little use when applied in the present context since under the Illinois Uniform Gift to Minors Act, ILL. REV. STAT. ch. 110-1½, § 201 (1979), the gift of a beneficial interest in a land trust is not proper "custodial property."
beneficial interest should qualify assuming that the interest is capable of being meaningfully valued. Gifts to joint tenants and tenants in common whereby each beneficiary has the power of direction and no concert of action is required should also qualify. Each tenant has a definable interest in the rents and profits and the ability to direct the sale or conveyance of the underlying realty. Taken a step further, joint tenants may be given immediate and qualifying interests in particular parcels with survivorship rights in the other tenants’ particular parcels. Once again, the immediate interest in the particular parcel coupled with the power of direction over that parcel should qualify whereas remainders would not.

The problem with the foregoing qualified gifts is that the donor may not wish to actually divest himself of all dominion and control, especially if the gift is the family farm. However, a donor might effectively prevent the objects of his bounty from dividing up the farm prematurely by the execution of a long term lease, and/or the practical threat of disinheritance.

Next, consider a gift of 100 percent of the beneficial interest to a single donee with the donor retaining the power to direct the trustee. The power of direction is tantamount to a general power of appointment. Thus, the gift is disqualified as a future interest. Not only is the gift revocable by exercise of the power, but it is incapable of valuation even as an interest in the income due to the uncertain duration of the interest. Likewise, a gift of 100 percent of the beneficial interest to one donee with a gift of the power of direction to another donee is disqualified; it does not matter that the donor has parted with all dominion and control.

Consider a gift of fifty percent of the beneficial interest with retention by the donor of the other fifty percent, coupled with creation of a joint power of direction. There is no inherent problem in qualifying a joint interest in property for the section 2503(b) exclusion. But what of the contingency that the necessity for concert of action creates? Outside the land trust context, the IRS has not contested the eligibility of the exclusion for joint interests in realty. Although joint tenants in real estate have recourse in partition proceedings when concert of action is impossible due to deadlock, joint tenants in the beneficial interest of a land trust generally do not. In Illinois, however, at least

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60. But see H. KENO, KENO ON LAND TRUSTS 2-29 to 2-30 (Ill. Inst for CLE 1978), for a discussion of the fiduciary capacity of a holder of the power of direction who has no beneficial interest.

61. Such an issue really involves valuation of the joint interest. See note 62 and accompanying text infra.
one court has applied this partition doctrine, previously limited to real estate interests, in the land trust setting.\textsuperscript{62} The argument may be made that the ability of a beneficiary to obtain partition of the beneficial interest should eliminate the distinction in treatment of the two forms of ownership.

Taken a step further, consider gifts of multiple fractions, such as tenths, coupled with equal control of the power of direction, or with provision that a majority of or that two-thirds of the beneficiaries may direct the trustee. In either case, there is no valid reason why the gift should not qualify as a present interest as long as other gifts of jointly owned and controlled property are held to qualify.\textsuperscript{63} If the power of direction is lodged in one controlling donee, however, the logic of the analogy fails. If the controlling holder of the power is the donor, his general power disqualifies all of the gifts. If the controlling holder is a donee, the gift to that donee may qualify while the gift to the other minority donees would probably not qualify. Unlike the duty imposed on majority shareholders toward minority shareholders, a majority holder of the power of direction has rarely had such a duty imposed on him, but rather, may direct the trustee to deed the property to the grantee of his choice and to pay the proceeds per his direction, thus completely defeating the interests of the minority beneficiaries. However, if the power requires concert of action, the contingency of such concert of action may never occur, and such a contingency may itself disqualify the gift.\textsuperscript{64}

It is conceivable that this distinction in rights of the minority in the two forms of ownership could be remedied by agreement. By imposing upon the majority the duty to distribute all proceeds and earnings according to the respective percentage interests held by the beneficiaries, at least annually, and by limiting transfers of the realty to those for full and adequate consideration based upon some predetermined indicia of fair market value, the minority interests are made meaningful and immediate. Only the timing would be left to the majority, and the general power of appointment would be destroyed. Yet mere control over the timing, at least if it is retained by the donor,

\textsuperscript{62} See Regas v. Danigeles, 54 Ill. App. 2d 271, 203 N.E.2d 730 (1964) (general equitable powers of court could properly require dissolution of deadlock between land trust beneficiaries, defeating purpose of trust, by means of judicial sale of all beneficial interests with proceeds to be divided in accordance with each beneficiary's respective interest).

\textsuperscript{63} But see note 60 supra. The issue is one of intent of the donor of the power.

\textsuperscript{64} See, e.g., Heringer v. Commissioner, 235 F.2d 149 (9th Cir. 1956); Chamin v. United States, 333 F.2d 972 (Ct. Cl. 1968) for proposition that minority interest in corporate stock does not afford sufficient dominion and control over corporation to qualify as a present interest.
would be enough to disqualify the gifts of the minority interests, since postponement, or the power to postpone enjoyment, is sufficient dominion and control to defeat any argument that the minority has a present interest.

It seems reasonable that gifts of equal fractions of both the beneficial interest and the power of direction to multiple donees should qualify as present interests. Since as in gifts of realty in joint ownership the mere form of joint ownership should not destroy the substance of the gift.

**Valuation: The Lingering Question**

The next obstacle facing the determined donor is the value of these fractional gifts. Section 2512(a) provides that the value of a gift is to be determined as of the date of the gift. Thus, the typical procedure has been to have the real estate which is the trust res appraised each year at the time the gift is made. The dollar value of the entire trust is then apportioned to each donee-beneficiary according to his percentage interest. Assuming that the donor desires to make only gifts valued at less than $3,000, the appropriate percentage of the whole is then doled out among the objects of the donor's bounty accordingly.

Such a simplistic approach ignores several significant issues. First, the IRS has long recognized that majority and minority interests in both corporate stock and jointly held realty are properly valued at a premium or discount over the proportionate value of the whole. 66 A variety of methods might be conceived whereby the value of a fractional share in the beneficial interest of a land trust can be ascertained. Viewed as similar to ownership in a corporation, the value of a fractional share would be based upon such factors as book value, earning capacity, anticipated profits, dividend yield, and marketability. A more similar situation is that of the gift of a minority joint interest in realty. Since in both the land trust and the joint tenancy situation the question of dividend yield is generally avoided, all net profits should pass proportionately to the owner-beneficiaries. In both situations there is the inconvenience involved in dealing

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65. I.R.C. § 2512 provides in part:
   (a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.
   (b) Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar quarter.

with co-owners. The point is that any annual appraisal should take into account market conditions, similar sales of fractional interests, rental value, and a premium or discount for control (i.e. power of direction) or lack of it.

What makes the method of appraisal even more critical in gifts of land trust interests is that most of these gift-giving plans aim at removal of just enough of the beneficial interest from the estate of the donor to maximize the annual exclusion. In limiting the gift to $3,000 or less, however, the donor leaves the question of value open for an indefinite period of time. Payment or assessment of some gift tax is required to start the statute of limitations running against the IRS. Thus, by embarking upon a long-term plan of giving fractional shares purportedly valued at less than the amount of the annual exclusion, the donor may be subjected to audit and reassessment many years after the probative evidence was readily available.

The problem with fixing value against the IRS is compounded by section 2505(a). Due to the requirement that to the extent available the unified credit allowable must be applied to offset the tax otherwise due, a donor would have to make substantial gifts in the first year of the plan to have the benefit of starting the running of the statute of limitations. Although the three year statute of limitations for assessment of any deficiency would still apply, the IRS would not be barred from increasing the value of prior gifts for the purposes of computing the tax on later gifts.

An additional risk involved in the valuation of gifts of fractional shares may be implied by a broad reading of Revenue Ruling 79-7. In a ruling attacked as "conceptually wrong" by

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68. I.R.C. § 2505(a) provides:
   In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar quarter amount equal to—
   (1) $47,000, reduced by
   (2) the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar quarters.

The Economic Recovery Tax Bill of 1981, Pub. L. No. 97-34 (to be codified in scattered sections of 26 U.S.C.) at section 401 amends sections 2010(a), 2505(a), and 6018(a) by increasing the unified credit to $192,800.

69. See Rev. Rul. 79-398, 1979-2 C.B. 338, 339 which provides: "Based on the specific language of section 2505(a) of the Code, the application of the unified credit is mandatory." See also ABA Committee on Estate and Gift Taxes Final Draft of Recommendation No. 1980-5.
70. Id.
one writer, the IRS ruled that a gift of a minority block of corporate stock which was required to be pulled back into the donor's gross estate under section 2033 due to the death of the donor within three years of the gift must be added to a retained block of the same corporate stock which was includible in the gross estate under section 2035(a), and that the aggregate of the two blocks of stock must be valued as a majority interest. Extrapolating from Revenue Ruling 79-7, any gift of a beneficial interest valued at a discount for minority shares could also be pulled back into the gross estate at a higher value in the event of the donor's untimely death.

CONCLUSION

In view of the previously discussed limits of McClure and the line of cases grappling with the definition of present as opposed to future interests, gifts of fractional shares of the beneficial interest in an Illinois land trust are not per se disqualified from the section 2503(b) exclusion. When structured appropriately, transfers of shares of beneficial interest coupled with a proportionate share in the power of direction should qualify for the exclusion, absent a majority share in the power of direction retained by the donor or transferred to one of several donees.

Mechanically, the assignment must be without consideration, accepted by the assignee, and lodged with the trustee to be a completed gift. The power of direction must also be held so as not to give anyone a general power of appointment over the underlying realty, the proceeds, or the timing of conveyance. For obvious reasons, the donees should not be minors, and cannot be custodians under the Uniform Gift to Minors Act.

Values must be established by appropriate methodology, and new appraisals prepared each time a gift is to be given. The initial gifts must be sufficient in amount to expend the unified credit and create a tax liability of at least a dollar in order to fix a value against the IRS.

73. I.R.C. § 2033 provides: The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.
74. See note 68 supra. But see section 424 of the Economic Recovery Tax Bill of 1981, Pub. L. No. 97-34 (to be codified in scattered sections of 26 U.S.C.) which adds a new section to the Internal Revenue Code, 2035(d). This section changes the applicability of section 2305(a) for some situations involving the estates of decedents dying after December 31, 1981.
Viewed in light of the foregoing restrictions, the practicality of making gifts of fractional shares of land trusts should be carefully considered. Currently, the limited dollar value of the exclusion may make it cost prohibitive when appraisers' fees, attorneys' fees, and the contingent liability for deficiencies and related valuation errors are taken into consideration. Likewise, the requirements imposed upon the donor in terms of what he must part with in money's worth and control may make the plan altogether unattractive. One thing is certain: It will be rare when all factors will weigh in favor of any extensive gift of a fractional share of an Illinois land trust.
