Search the complete LISI®, ActualText, and LawThreads® archives.

Search archives for: Find it

Newsletters Click for Search Tips Click for **Most Recent Newsletters**

Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2001

Date: 23-Aug-12
From: Steve Leimberg's Estate Planning Newsletter
Subject: **Bramwell and Mullen: Donative Promise Can Use Up Gift Tax Exemption**

"The authors propose a strategy that enables taxpayers to make substantial taxable gifts in 2012 without currently parting with any of their wealth. The strategy is simple: Instead of transferring cash or other property this year, an individual can promise to make gifts to the donees in the future.

If the promise is designed so that it is enforceable under local law, it will be treated as a taxable gift when made and may successfully use up the $5.12 million gift and GST tax exemption amounts while they are still available. The strategy also has nontax benefits that many individuals may find compelling.

Finally, the strategy enables married taxpayers to make gifts in 2012 while avoiding potential "clawback" tax upon the death of the first spouse to die.

For these reasons, many taxpayers who have not yet used the increased gift tax exemption amount should consider doing so this year by making an enforceable promise to make gifts in the future."

Austin Bramwell and **Lisi Mullen** provide members with commentary that is sure to spark interest – if not controversy – among **LISI** members: donative promise gifts as a claw-back management strategy.

LISI provides this commentary – not as an endorsement of the concept –

but as "food for thought." The views expressed herein are the authors' own. We'd be interested in reader's input – which you can readily add to **LISI's** COMMENTS BOX by clicking the link at the bottom of this newsletter.

Austin W. Bramwell is an associate in the trusts and estates department of **Milbank, Tweed, Hadley & McCloy LLP**. He has written previously for *Journal of Taxation*, *Estate Planning*, *Trusts & Estates*, *Probate & Property*, **LISI**, and other publications.

Elisabeth ("Lisi") Madden Mullen is an associate in the trusts and estates department of **Milbank, Tweed, Hadley & McCloy LLP**. She has written previously for *Journal of Taxation*, *Estate Planning*, *Tax Notes*, **LISI**, and other publications.

The authors thank **Jonathan G. Blattmachr** for his helpful comments.

Here is their commentary:

EXECUTIVE SUMMARY:

The authors propose a strategy that enables taxpayers to make substantial taxable gifts in 2012 without actually parting this year with any of their wealth. The strategy is simple: Instead of transferring cash or other property this year, an individual can promise to make gifts to the donees in the future. If the promise is designed so that it is legally enforceable under local law but is not in exchange for consideration in money or money's worth, it will be treated for federal gift tax purposes as a taxable gift when the promise is made (rather than when it is later paid) and will successfully take advantage of the $5.12 million gift and estate tax exemption amount while it is still available.

The strategy also has nontax benefits that many individuals may find compelling.

Finally, the strategy enables married taxpayers to make gifts in 2012 while avoiding potential "clawback" tax upon the death of the first spouse to die.

For these reasons, the authors suggest that many taxpayers who have not yet used up the increased gift tax exemption amount should consider doing so this year by making a legally enforceable promise to make gifts in the future.

FACTS:

The federal gift and estate tax exemption amount, currently $5.12 million, is scheduled to revert to $1 million after this year. The highest estate tax rate, meanwhile, is schedule to increase from 35% to 55% (and, in some cases, up to 60%).

The impending decline in the exemption amount and increase in estate tax rates create a powerful incentive to make taxable gifts this year. Absent further legislation, for example, a taxable estate of $5.12 million, if the decedent made no taxable gifts, will generate $2,111,000 of estate tax in 2013. Taxpayers can potentially avoid that tax entirely by making taxable gifts this year up to the $5.12 million exemption amount.

Unfortunately, not all taxpayers feel that they have the wherewithal to immediately part with $5.12 million of wealth. An individual worth exactly $5.12 million, for example, if he or she has made no prior taxable gifts, would need to give away 100% of his or her assets in order to use up the exemption amount in full this year.

Although the $2,111,000 in potential estate tax savings represents approximately 41% of the individual's wealth, he or she may nonetheless decide that the tax savings at death are not worth the lifestyle compromises required to make substantial taxable gifts this year. Consequently, many individuals, especially the relatively less affluent, will fail to take advantage of the increased exemption amount available in 2012.

COMMENT:

Happily for such taxpayers, we believe there is a strategy whereby they can use up the exemption amount available this year - yet still retain title to and control of all their wealth.

Under this strategy, an individual, instead of giving away cash or other property this year, promises to pay cash or other property to the donees in the future. If the promise (hereinafter, a "donative promise") is legally enforceable under local law, it will be treated as a taxable gift.[i] Although a donative promise will not qualify at the taxpayer's death for a deduction under Code section 2053(a)(3), it will also not be treated as an adjusted taxable gift under Code section 2001(b). Consequently, a donative promise can save estate tax on the difference between this year's exemption amount and the lower exemption amount that will be available beginning in 2013.

Example: Unmarried Taxpayers

For example, suppose that Ruth, an unmarried individual who has made no prior taxable gifts, has exactly $5.12 million of assets. She makes an enforceable promise to pay her children $5.12 million (plus interest at the applicable federal rate) in five years. The promise will be treated as a taxable gift at the time that it becomes enforceable under local law.[ii] In addition, as discussed in further detail below, the value of the gift can be reported as being equal to the full $5.12 million face amount of the promise. Ruth's donative promise, therefore, uses up all the entire gift tax exemption amount.

Now suppose that Ruth dies in 2013 with exactly $5.12 million of assets. Section 2053(c)(1)(A) of the Code provides that a claim founded on a promise or agreement cannot generally be deducted against the taxable estate - unless it was contracted bona fide and for full and adequate consideration in money or money's worth. Here, Ruth's promise was *not* made for a valuable consideration. Her children's claim against the estate, therefore, will not qualify for a section 2053 deduction. Assuming (for simplicity) that there are no other deductions, Ruth's taxable estate will be $5.12 million.

To determine the estate tax due under the calculation procedures of section 2001(b) of the Code, Ruth's executors will need to determine whether any "adjusted taxable gifts" need to be included in the amount subject to estate tax. Normally, a gift that is not included in a decedent's gross estate qualifies as an "adjusted taxable gift." In this case, Ruth's gift is not brought back into the gross estate under one of the "string" sections (i.e., sections 2035 through 2042 of the Code) that can cause property transferred during lifetime to be included in the gross estate.[iii]

Treating a donative promise gift as an adjusted taxable gift, however, would lead to double taxation: The assets used to satisfy the promise would be taxed once as part of the gross estate under section 2033 of the Code (but without a corresponding deduction under section 2053 of the Code) and a second time as an adjusted taxable gift. Public policy, therefore, would seem to demand that a donative promise gift *not* be treated as an adjusted taxable gift to the extent that the promise is not satisfied during lifetime.[iv]

In Rev. Rul. 84-25, the IRS confirmed that a donative promise gift, although it does not qualify for a deduction under section 2053 of the Code, is also not an adjusted taxable gift. Thus, Ruth's $5.12 million gift in 2012 is not added to the estate tax calculation. In other words, a

tentative tax will be calculated on the taxable estate of $5.12 million and not on the sum of the taxable estate and Ruth's $5.12 million donative promise gift in 2012.

The next step in the estate tax calculation procedure will be to subtract the gift tax which "would have been payable" on the donative promise gift that Ruth made in 2012. Assuming that the IRS cannot recapture or "claw back" tax on gifts that at the time were under the gift tax exemption amount, the gift tax payable will be $2,111,000. After this amount is subtracted from the tentative tax, the remaining estate tax will be $345,800, which will be equal to the unified credit under section 2010 of the Code. No estate tax will be due at Ruth's death. Thanks to Rev. Rul. 84-25, Ruth's donative promise successfully uses up the $5.12 million exemption amount that was available to her in 2012.

Example: Married Taxpayers

The donative promise strategy also works for married couples who intend to defer the payment of estate taxes until the death of the surviving spouse. To be sure, if the first decedent makes a donative promise gift in 2012, his or her taxable estate may be larger than the estate tax exemption amount that will be available beginning in 2013. At first blush, therefore, it may seem that, contrary to the desire of many married taxpayers, the donative promise strategy will cause estate tax to be paid at the first decedent's death.

In fact, however, the donative promise strategy works as well for married taxpayers as for unmarried taxpayers. For example, suppose that Jake, a married individual with $10 million of assets who has made no prior taxable gifts, makes a $5.12 million donative promise gift to his children in 2012. He dies in 2013 leaving his entire estate, after the payment of debts, to his wife. Jake's executors pay over $5.12 million to Jake's children and the $4.88 million balance to Jake's wife.[v] Jake's estate, therefore, may only take a marital deduction of $4.88 million, which leaves a taxable estate of $5.12 million.

Just as in Ruth's case, Rev. Rul. 84-25 will prevent Jake's donative promise gift from being added to the amount subject to estate tax as an adjusted taxable gift. The gift taxes payable on the gift, meanwhile, will reduce the tentative estate tax to $345,800 (assuming no clawback of tax). Once again, the unified credit will absorb all of the tax and no estate tax will be due.

In short, despite that a donative promise in 2012 may generate a taxable

estate that is larger than the exemption amount available after 2012, it will not cause estate tax to be due at the first decedent's death (assuming that clawback, discussed below and not a problem unique to donative promise gifts, does not apply).

Clawback Management

The examples discussed above assume that the gift tax that "would have been payable" on a gift made in 2012 by a decedent who dies in 2013 or later will reduce the amount of estate tax at death, even though no gift tax was actually assessed. As has been discussed in prior **LISI** newsletters,[vi] however, it is not entirely clear that the IRS must permit a reduction of estate tax for a hypothetical tax on gifts that were under the gift tax exemption amount. If the reduction is denied, the IRS could effectively recapture or "claw back" tax on the difference between the (higher) exemption amount available at the time of the gift and the (lower) estate tax exemption amount available at death.

It may be unlikely at this point that the IRS will actually assert the right to recapture tax on gifts that were covered by the exemption amount available at the time of the gifts. For one thing, Congress may eliminate the threat of clawback if the exemption amount is reduced.[vii] Recently published temporary and proposed Treasury Regulations also clearly foreclose the similar threat of clawback that could have arisen where a decedent, by remarrying and surviving a second spouse, lost gift tax exemption he or she had inherited from a prior deceased spouse.[viii] That the IRS does not believe in clawback in the portability context may indicate that the IRS likewise does not believe in clawback in the context of decreasing exemption amounts.

That said, any remaining threat of clawback is especially severe for married couples: If the first decedent's executors are required to pay clawback tax, they may be forced to pay the tax out of the marital share passing to the surviving spouse, which will reduce the marital deduction available to the estate, which will increase the estate tax, which will further reduce the marital deduction, and so forth in a vicious circle. Suppose, for example, that Marci, a married taxpayer worth $10 million who has made no prior taxable gifts, makes a $5.12 million cash gift in 2012 and dies in 2013 with $4.88 of assets remaining, all of which she attempts to leave outright to her husband. If the IRS successfully claims the power to claw back tax on the $5.12 million gift, Marci's estate will be required to pay $4,691,111.11 of estate tax. Only $188,888.89 will pass to Marci's husband.

Now suppose instead that Marci gives her children a $5.12 million note enforceable under local law. The note provides that, if it remains outstanding at Marci's death and Marci predeceases her husband, then the amount payable under the note will be reduced to the maximum amount that can be paid to Marci's children without causing estate tax to be due at Marci's death.[ix] Marci once again dies in 2013 survived by her husband. As the maximum amount that can be paid to Marci's children in 2013 without causing estate tax to be due would (if there is clawback) be $1 million, Marci's executors would be required to pay only $1 million to Marci's children. The balance of her assets ($9 million) could then be paid over to Marci's husband. Marci's taxable estate, therefore, would be $1 million, which is exactly equal to the exemption amount available in 2013. A partial cancellation provision that is incorporated into a donative promise gift, in short, can prevent clawback tax at the death of a married taxpayer.[x]

Making the donative promise enforceable

For the donative promise strategy to succeed, it is crucial that the promise be enforceable under local law. If the promise is unenforceable, no taxable gift occurs and no gift tax exemption will be used.[xi] Donors and donees, therefore, should take care that the donative promise is made pursuant to an agreement that satisfies the elements of a contract, i.e., that there be a manifestation of mutual assent and a bargained-for consideration.[xii]

To illustrate, consider the following example:

> Alvina loves her daughter, Vanessa, but privately has reservations about the way Vanessa is raising her own children. In particular, Vanessa has chosen to send her children to an elite private school where they rub elbows with the rich and famous. Alvina believes in supporting the public school system and fears that her grandchildren are learning the "wrong values."
>
> Alvina approaches Vanessa and tells her of the substantial potential estate tax savings from making taxable gifts this year. However, Alvina cannot afford to just give away the money this year. Instead, Alvina says that she will promise to give Vanessa $5.12 million in the future. Vanessa expresses deep gratitude to Alvina for even thinking about saving estate tax at Alvina's death.
>
> Alvina then explains that there is a catch: the promise must be

> enforceable in order to save estate tax, but the only sure way to make it enforceable is for Vanessa to do something in return for the $5.12 million promise. Alvina confesses that she had always wished that Vanessa had sent her children to public school. As a condition of promising to give her $5.12 million in the future, therefore, Alvina will ask that Vanessa send her children for one year to a local public school. Vanessa says that she will agree.
>
> Alvina and Vanessa then sign an agreement reciting that Alvina wishes to make a taxable gift to Vanessa in order to save estate taxes, and stating that, in consideration for the Alvina's promise to pay her $5.12 million, Vanessa will enroll her children in public school. Vanessa enrolls her children in public school in the fall.

Can Vanessa enforce Alvina's promise? In our view, the answer is yes. It is well-established that consideration (i.e., any bargained-for legal detriment, such as an act or forbearance that the promissee has no legal duty to perform[xiii]) need not be adequate in order to be sufficient.[xiv] As one authority has written:

> It is an elementary and oft quoted principle that the law will not inquire into the adequacy of consideration as long as the consideration is otherwise valid or sufficient to support a promise. By this is meant that so long as the requirement of a bargained-for benefit or detriment is satisfied, the fact that the relative value or worth of the exchange is unequal is irrelevant so that anything which fulfills the requirement of consideration will support a promise, regardless of the comparative value of the consideration and of the thing promised. The rule is almost as old as the doctrine of consideration itself.[xv]

Another states:

> The rule is too well settled, even to admit of argument, that consideration in fact bargained for is not required to be adequate in the sense of equality in value. The mere inadequacy, alone, is never sufficient to vitiate a contract or conveyance otherwise valid, and the courts are not disposed to enter upon nice calculations to strike a balance on the one side or the other. Absolute equality is not to be hoped for, and is seldom attained in men's dealings one with the other. Nor is consideration to be measured in terms of dollars and cents alone; convenience, avoidance of troublesome details and efforts are proper elements.[xvi]

Thus, a decedent's promise to pay a friend $5,000 for a canary – an

extraordinarily exorbitant price at the time for a bird – was held enforceable against his estate.[xvii] Another promise to pay $5,000 – again, an exorbitant price, especially at the time – in exchange for ministering to the decedent's feet was held to be enforceable.[xviii] In *Hamer v. Sidway*,[xix] the court famously held that refraining from using alcohol or tobacco was sufficient consideration to make a promise enforceable.

The IRS, citing *Hamer*, has itself held that a promise to pay a donee money in exchange for the donee graduating from college was a taxable gift when the donee graduated.[xx] Other considerations that have been held to be legally sufficient include attending the donor's funeral,[xxi] changing one's name,[xxii] quitting one's job[xxiii] or giving a child a certain name.[xxiv] Further examples of inadequate yet legally sufficient consideration abound.[xxv] In like fashion, that Vanessa's promise to enroll her children in public school has no fair market value nor even (compared to the potential estate tax savings) very much value to Alvina is, under traditional contract principles, irrelevant to whether Vanessa's consideration is sufficient.

The principle that the law will not inquire into the adequacy of consideration, however, does not settle whether Alvina's promise is enforceable. The deeper question posed by Vanessa's performance for Alvina's promise is whether it was truly "bargained for." In the "classical" view, consideration is not insufficient merely because "obtaining it was not the motive or a material cause inducing the promissor to make the promise."[xxvi] As an illustration, the Restatement (First) of Contracts offers the following:

> A wishes to make a binding promise to his son B to convey to B Blackacre, which is worth $5000. Being advised that a gratuitous promise is not binding, A writes to B an offer to sell Blackacre for $1. B accepts. B's promise to pay $1 is sufficient consideration. [xxvii]

In other words, a donor may always make a promise enforceable by inducing a nominal consideration, even though both donor and donee know that the motive is simply to make a gift.[xxviii] Thus, that Alvina's primary purpose is to save estate tax by making a taxable gift would not, in the classical view, undermine the sufficiency of Vanessa's consideration.

More recent authorities, however, retreat from the Restatement (First) of Contract's flat assertion that motive is irrelevant. Restatement (Second) of Contracts instead warns that a "mere pretense of bargain does not suffice." As an illustration, it gives the following:

> A desires to make a binding promise to give $1000 to his son B. Being

advised that a gratuitous promise is not binding, A offers to buy from B for $1000 a book worth less than $1. B accepts the offer knowing that the purchase of the book is a mere pretense. There is no consideration for A's promise to pay $1000.[xxix]

The Restatement (Second) acknowledges that "[e]ven where both parties know that a transaction is in part a bargain and in part a gift, the element of bargain may nevertheless furnish consideration for the entire transaction."[xxx] The Restatement (Second) also generally endorses the well-settled rule that a promissor's motivation for inducing a consideration is normally irrelevant to whether it was actually bargained for.[xxxi] Nonetheless, it clearly raises the possibility that, even though the donor and donee both wish to make donor's promise legally enforceable, a donative promise will be held unenforceable if they both know that the donor's motive in seeking consideration from the donee is to make a gift. In Alvina's case, since her overwhelming motive is to save estate tax by making a taxable gift, it is unclear whether Vanessa's act of enrolling her children in public school was truly bargained for.

The Restatement (Second)'s about-face on nominal consideration for a promise to make a gift has been widely criticized.[xxxii] As Samuel Williston remarked, "It is something, it seems to me, that a person ought to be able to do, if he wishes to do it—to create a legal obligation to make a gift. Why not? . . . I don't see why a man should not be able to make himself liable if he wishes to do so."[xxxiii] Unfortunately, there does not appear to any case law to settle which Restatement's position is correct.[xxxiv]

That said, in the our view, even under the Restatement (Second)'s position, Alvina's promise is enforceable. While Alvina's primary motive is to save estate tax, she also genuinely desires to see her grandchildren enrolled in public school. Even the Restatement (Second) allows that presence of some non-donative motive for seeking consideration suffices to make it legally sufficient.[xxxv] As there is at least some element of bargain in Vanessa's agreement to enroll her children in public school, therefore, Alvina's promise should be enforceable.[xxxvi]

As a general matter, it seems that the more strongly the donor actually desires the performance or forbearance furnished as consideration, the more likely the promise is to be upheld as enforceable. Planners recommending the donative promise strategy, therefore, should review carefully with the donor what lifestyle concessions he or she wishes to extract from the donees. The more meaningful to the concession (and the more reluctant the donees to make it), the more likely the strategy is to succeed. The requirement that a promise must be supported by consideration in order to use up gift tax exemption turns out to be a significant

non-tax benefit: In order to make a taxable gift of a promise to pay money in the future, a donor simply has no choice but to demand, on the advice of counsel, that the donees take actions that they might otherwise be reluctant to perform.

Must the promise be bona fide?

Just because an instrument is enforceable under local law does not mean that it will always be respected for tax purposes. For example, the IRS has ruled, controversially, that if a taxpayer sells property for a note that he or she does not intend to enforce, the note will be disregarded in determining the value of the gift.[xxxvii] The IRS's attack on notes that are not bona fide in the context of installment sales may cause some concern that the IRS will similarly attack a donative promise gift on the grounds that the donors and donees did not intend to enforce the terms of the gift nor the donor and donee to honor it. Some might worry, in other words, that, contrary its usual practice, the IRS will actively seek to *prevent* taxpayers from reporting transactions as taxable gifts.

Needless to say, no individual should make a donative promise gift unless he or she fully intends to honor the terms of the promise. For taxpayers concerned that the IRS will question their intentions, however, it is comforting to observe that the *intent* of the parties is irrelevant to determining whether a transaction constitutes a taxable gift.[xxxviii] On the contrary, "application of the [gift] tax is based on the objective facts of the transfer and the circumstances in which it is made, rather than the subjective motives of the donor."[xxxix] In Rev. Rul. 79-384, for example, a child sued a parent to enforce a promise to pay money upon the child's graduating from college. Despite the parent's evident lack of intent to honor the promise, the IRS held that the parent made a taxable gift on the date the child graduated and the promise became enforceable under local law.

Consistent with the notion that subjective intent is irrelevant to whether a transfer is a taxable gift, Rev. Rul. 84-25 holds that the "gratuitous transfer of a *legally binding* promissory note is a completed gift." The ruling says nothing about whether the promissees intended to enforce the note or the whether the taxpayer intended to satisfy it. Therefore, so long as the promise is legally enforceable and the consideration received has no value in money or money's worth, the promise will be a taxable gift.

In any case, taxpayers can foreclose any "risk" that the IRS will attempt to void donative promise gifts by adequately disclosing them on their gift

tax return. Once a donative gift is adequately disclosed and the period for assessment of gift tax lapses, any argument by the IRS that the gift was not bona fide would be precluded under Code section 2001(f). The gift tax assessment period will begin to run so long as the gift is adequately disclosed and reported as a completed gift, even if the gift is ultimately determined to have been incomplete.[xl] Thus, if a donative promise is reported as a taxable gift and the gift tax assessment period lapses, the IRS must treat the promise as a taxable gift when calculating estate tax at death.

Is there a downside?

Suppose that, despite the unbroken line of authority supporting the proposition that an enforceable promise is a taxable gifts,[xli] the IRS nonetheless seeks to void a donative promise gift made in 2012. If the IRS succeeds, the donor will simply have failed to have made a taxable gift and his or her estate will not be able to subtract from the amount of estate tax due the gift taxes that "would have been payable" on the donative promise gift. The same result would have obtained had the donor made no taxable gifts at all. For taxpayers who do not have the means to make conventional taxable gifts this year, therefore, there is no gift or estate tax downside to making a donative promise gift.[xlii]

Valuing the promise

In general, the value of property for gift tax purposes is the price at which it would exchange hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both being reasonably apprised of the relevant facts.

This general rule, however, is subject to a number of specific rules governing the valuation of various types of property. In particular, the value of a promissory note "is presumed to be the amount of unpaid principal, plus accrued interest to the date of the gift, unless the donor establishes a lower value."[xliii] Under this rule, it seems that a taxpayer may report the value of a note as being equal to the amount due, even though the value of the note could in theory be discounted (such as for lack of security, insolvency of the borrower, date of maturity, etc.). Indeed, as the Treasury Regulations only permit the *donor* (not the IRS) to establish a lower value, it may be (although it is not certain) that the IRS is precluded from challenging a taxpayer's position that the value of a note is equal to the principal required to be paid.

In the context of the donative promise strategy, the presumption that a

note is equal to its face value is helpful in a number of ways:

First, the donor need not engage an appraiser to value a donative promise gift; instead, he or she may simply report the face value of the promise as its value for gift tax purposes.

Second, the donor, to use up his or her exemption amount, need not increase the face value of the promise in order to make up for any discount.

Third, if the value of the promise is equal to its face value, there will generally not be any mismatch between the value of the gift in 2012 -- which will determine the amount of gift taxes which "would have been payable" under section 2001(b) of the Code -- and the amount that the taxpayer's executors will actually be required to pay to the donees at death -- which may (such as in the case of a married donor who plans to defer estate taxes until the death of the surviving spouse) determine the size the taxable estate.

Finally, for married taxpayers, the ability to report the value of a donative promise as being equal to the full amount of principal can help manage the risk of clawback tax. As discussed above, a married donor should consider including a partial self-cancellation provision that, if the donor predeceases his or her spouse, will automatically reduce the amount required to be paid under the note to the maximum amount that can be paid without causing estate tax to be due at the donor's death.

The presumption that a note is equal to its face value seems to permit the donor to take the position that there is no discount in virtue of the self-cancellation feature. That is, rather than attempt to determine what the discount would be based on such uncertain factors as whether the law permits the IRS to claw back tax or the probability that Congress will not act to prevent a decrease in the exemption amounts, it seems that the donor can report the value of the note as being equal to the full principal amount, without taking the partial cancellation clause into account.[xliv]

Is payment of the promise taxable income?

Donees who enter into a donative promise gift agreement with the donor should consider whether any payment to them is taxable income rather than a gift excludable from gross income under section 102(a) of the Code. Just because a transaction is a taxable gift for gift tax purposes does not mean that it is a gift for income tax purposes.[xlv] In particular, whereas a taxable gift is generally any completed transfer (other than in

the ordinary course of business) for less than full and adequate consideration in money or money's worth, regardless of motive, a taxable gift for income tax purposes generally requires, in the words of the *Duberstein v. Comm'r*,[xlvi] a "detached and disinterested generosity . . out of affection, respect, admiration, charity or like impulses." Unless the donees can establish that that the payment by the donor was made with the requisite motive, therefore, the payment could conceivably be treated as taxable income earned by the donees.[xlvii]

That said, while there is no authority directly on point, it should not be difficult to establish that the donor was indeed motivated by a "detached and disinterested generosity." The donor's very purpose in making a donative promise gift is to cause more wealth to pass tax-free to the donees. Any payment to the donees, therefore, should be treated as a gift excludable from the donees' income.

In addition, courts have held where an individual deliberately overpays for property or services, the overpayment constitutes a gift.[xlviii] In making a donative promise, the donor deliberately agrees to overpay for the value of the donees' consideration. Consequently, the overpayment should be excluded from the donees' income just as in the case of a gift made for no consideration.

Finally, when the donor and the donee are intimately associated, courts have typically treated a payment to the donee, even if in exchange for some kind of benefit, as a gift.[xlix] As a donative promise will typically be made to family members, the donor's natural affection for the donees will tend to establish that the payment to the donees was a gift.

Careful planning can in any case minimize the risk that the donees will have taxable income:

First, wherever possible, the donor, rather than the donees, should initiate discussion of making a donative promise gift.

Second, the documents implementing the donative promise gift should emphasize the donor's wish to pass wealth to the donees. The donative promise documents can even recite that the donor has asked the donees to furnish consideration so as to enable the donor to make gifts to them in a tax-efficient manner.

Third, the donees of the donative promise gift should be the same as the beneficiaries named in the donor's will or other testamentary documents.