Katz v. Commissioner, 49 B.T.A. 146 (1943)

A gift is considered complete for tax purposes when the donee receives the property, and its value is determined at that time, excluding any payments the donee receives directly from a third party as part of a pre-arranged sale of the gifted property.

Summary

The case concerns the timing and valuation of gifts of stock made by the Katzes to their children. The Board of Tax Appeals determined that the gifts were completed in 1937 when the stock was delivered, not in 1935 when the contract establishing the children's rights was signed. The Board excluded an $80,000 payment the children received from a third party (Strelsin) for the stock as part of the gift's value, as the payment never belonged to the parents. The Board also ruled that the value of the gifts should be reduced by the amount of income taxes the children paid as transferees due to the parents' insolvency.

Facts

The Katzes entered into a contract in 1935 that would eventually give their children stock in a company, contingent upon certain conditions being met. These conditions included the retirement of company debentures and the company achieving specific net earnings. The Katzes also had to remain actively involved with the company. In 1937, the conditions were met, and the children received the stock. The children also received $80,000 from Strelsin as part of a pre-arranged sale of the stock. The Commissioner determined deficiencies in gift taxes based on the gifts being completed in 1937 and including the $80,000 payment in the gift's value.

Procedural History

The Commissioner assessed gift tax deficiencies against the Katzes. The Katzes petitioned the Board of Tax Appeals for a redetermination of these deficiencies. The Board reviewed the Commissioner's determination, focusing on the timing of the gift, the valuation of the gift (including the $80,000 payment), and whether the value of the gift should be reduced by income taxes paid by the donees as transferees.

Issue(s)

1. Whether the gifts of stock were completed in 1935 or 1937 for gift tax purposes.
2. Whether the $80,000 payment received by the donees from Strelsin should be included in the valuation of the gifts.
3. Whether the value of the gifts should be reduced by the amount of income taxes paid by the donees as transferees of the donors.

Holding

1. No, because the gifts were not complete until the donees actually received the

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stock in 1937, as the 1935 contract was conditional.
2. No, because the $80,000 payment was consideration for the sale of stock and never belonged to the donors.
3. Yes, because the donees' liability for income tax arose at the time of receipt of the stock, and the donors' insolvency shifted the tax liability to the donees.

Court's Reasoning

The Board reasoned that a valid gift requires a gratuitous and absolute transfer of property, taking effect immediately and fully executed by delivery and acceptance. The 1935 contract was conditional, preventing it from being a completed gift at that time. The Katzes retained control over the stock transfer, as their continued association with the company was required. The $80,000 payment was part of a sale of stock to Strelsin and never belonged to the Katzes, so it could not be considered part of the gift. The Board cited *Otto C. Botz, 45 B. T. A. 970*, to support the argument that the tax liability arose at the time of the transfer. The Board also cited *Lehigh Valley Trust Co., Executor, 34 B. T. A. 528*, stating that transferee liability arises when a distribution makes the taxpayer insolvent. The Board concluded that the value of the gifts should be reduced by the amount of income taxes paid by the donees as transferees, citing *United States v. Klausner, 25 Fed. (2d) 608*.

Practical Implications

This case clarifies the requirements for a completed gift for tax purposes, emphasizing the importance of unconditional delivery and acceptance. Attorneys should advise clients that conditional promises of future gifts are not considered completed gifts until the conditions are met and the property is transferred. The case also highlights that payments made directly to the donee from a third party as part of a pre-arranged sale of the gifted property are not included in the gift's valuation. Furthermore, it confirms that donees who pay income taxes as transferees due to the donor's insolvency can reduce the value of the gift by the amount of taxes paid. This ruling impacts estate planning and gift tax strategies, providing guidance on how to structure gifts to minimize tax liabilities. Later cases would likely cite this to determine when a gift is considered complete and how to value it for tax purposes.

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