2 T.C. 285 (1943)

Income from property gifted outright is taxable to the donee, even if the gift satisfies a legal obligation of the donor, unless the property is held merely as security for that obligation.

Summary

Lawrence Miller transferred stock to his minor son and ex-wife as part of a divorce settlement. The Tax Court addressed whether the dividends from the stock transferred to his son and ex-wife were taxable to Miller. The court held that the income from the stock gifted to his son was not taxable to Miller because it was a completed gift and no trust was established. Further, the income from stock transferred outright to his ex-wife was taxable to her, not Miller, even though Miller guaranteed a minimum annual yield, because she had complete ownership of the stock and it wasn't merely held as security.

Facts

In 1935 and 1936, Miller gifted 12,500 shares of Frankfort Distilleries, Inc. stock to his minor son. Certificates were issued in the son's name but held by the corporation until Miller became the legal guardian in 1938. In 1938, Miller and his wife, anticipating divorce, agreed Miller would pay $5,000/year from the stock income for their son's support. These payments were not fully made; instead, a portion of the income was used, with court approval, to purchase insurance for the son's benefit, and the remaining funds were held in a guardianship account.

As part of a divorce property settlement, Miller transferred Standard Oil Co. of Kentucky stock to his wife, designed to yield $2,475 annually. Miller guaranteed this amount; if the stock yielded less, he'd pay the difference. The divorce decree approved this as a final property settlement.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Miller's income taxes for 1937 and 1938. Miller appealed to the Tax Court, contesting the taxability of the dividend income from the gifted stock.

Issue(s)

1. Whether the income from stock registered in the name of Miller's minor son is taxable to Miller.

2. Whether the income from stock transferred by Miller to his wife as part of a divorce settlement is taxable to Miller.

Holding

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1. No, because a valid gift of the stock was made to the minor son, and the income is therefore attributable to the son, not the father.

2. No, because Miller made an outright transfer of the stock to his wife, giving her complete ownership, and therefore the income is taxable to her, not Miller.

Court's Reasoning

Regarding the stock gifted to the son, the court found a valid gift was made, establishing the son as the owner. The court noted, "With that fact clearly established, it becomes apparent that thereafter the income from the property which was the subject of the gift was the income of the donee, and not that of the petitioner." The court dismissed any notion of a trust and emphasized that the divorce court could not unilaterally direct the expenditure of the child's funds. Because Miller did not use the funds to discharge his legal obligation of support, the income remained taxable to the son.

Concerning the stock transferred to the ex-wife, the court distinguished cases involving alimony trusts where the trust acts as a security device for ongoing obligations. Here, Miller transferred complete ownership. Quoting *Pearce v. Commissioner, 315 U.S. 543*, the court stated, "But where, as here, the settlement appears to be absolute and outright and on its face vests in the wife the indicia of complete ownership, it will be treated as that which it purports to be, in absence of evidence that it was only a security device for the husband's continuing obligation to support." The court found no reason to question the transfer's validity, even with Miller's guarantee of a minimum yield, emphasizing that the obligation was satisfied by the transfer, not secured by it.

Practical Implications

This case clarifies the tax implications of property transfers related to divorce and gifts to family members. It highlights that outright gifts of income-producing property generally shift the tax burden to the recipient, even if the gift is linked to a legal obligation like child support or alimony. The key factor is whether the transfer represents complete ownership or merely a security arrangement. Later cases would cite this when evaluating the substance of property transfers incident to divorce, focusing on the degree of control retained by the transferor. Legal practitioners use this to distinguish between transfers that shift tax liability and those that do not.

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