***Nathan H. Gordon Corporation v. Commissioner, 42 B.T.A. 586 (1940)***

The transfer of reversionary trust assets to the grantor does not constitute income when the grantor assumes substantial obligations to make payments to beneficiaries, and accrued interest on loans from the trust to the grantor is deductible if the grantor uses the accrual method of accounting.

**Summary**

Nathan H. Gordon Corporation created trusts that loaned it money. Upon termination of the trusts, the assets, including the corporation's debt, reverted to the corporation. The Commissioner argued the corporation recognized income either upon the transfer of assets or through cancellation of debt. The Board of Tax Appeals held the corporation did not realize income because it assumed obligations to make payments to trust beneficiaries. The Board also allowed the corporation to deduct accrued interest on the loans, as it used the accrual method of accounting and the interest obligation existed during the trust's life.

**Facts**

In 1931, Nathan H. Gordon Corporation assigned its reversionary rights in certain trusts to itself. The trusts had loaned the corporation a substantial amount of money. In 1936, upon termination of the trusts, the assets reverted to the corporation. These assets included the corporation's debt to the trusts.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency, arguing the transfer of assets to the corporation constituted income. The Commissioner later amended his answer, alleging the corporation received income when the trusts terminated. The Board of Tax Appeals reviewed the Commissioner's determination.

**Issue(s)**

1. Whether the transfer of assets from the trusts to the corporation upon termination constituted taxable income to the corporation.
2. Whether the corporation could deduct interest accrued on loans from the trusts in 1934 and 1935, even though the interest was not actually paid.

**Holding**

1. No, because the corporation assumed a substantial obligation to make payments to ascertained and unascertained beneficiaries, providing consideration for the transfer.
2. Yes, because the corporation used the accrual method of accounting, and the obligation to pay interest existed during the trusts' life.

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## Court’s Reasoning

The Board reasoned that the mere transfer of property to the corporation did not result in income. If transferred without consideration, it would be a gift; if with consideration, a purchase. Income only results from the sale or disposition of property, not its receipt. The Board found that the corporation’s assumption of obligations to make payments to beneficiaries constituted consideration. There was no cancellation of debt, and the corporation’s obligation to make these payments remained, supported by the value of the reversionary assets. Concerning the interest deduction, the Board noted the loans were bona fide, and the corporation was obligated to pay interest until the trusts terminated. While payment became moot upon termination due to the merging identities, the obligation existed. Since the corporation used the accrual basis, the accrued interest was deductible.

## Practical Implications

This case clarifies the tax treatment of reversionary trust assets and accrued interest when a grantor corporation assumes obligations upon trust termination. It demonstrates that assuming liabilities can constitute consideration, preventing the recognition of income upon asset transfer. It also confirms that taxpayers using the accrual method can deduct interest expenses when the obligation to pay exists, even if actual payment is later rendered moot by a merger of identities. The case emphasizes the importance of demonstrating actual obligations and using proper accounting methods to support tax deductions. It shows how subsequent tax code changes may require prospective application, as seen in the discussion of charitable contribution deductibility rules under the 1936 and 1938 Revenue Acts.

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