5 T.C. 443 (1945)

Intra-family stock transfers, followed by immediate borrowing of dividends by the transferor and continued control of the stock by the transferor, suggest the transfers were not bona fide gifts and dividends are taxable to the transferor.

Summary

Ralph and Herbert Anderson transferred stock in their family corporation to family members shortly before dividend declarations in 1937-1939. Immediately after dividend payments, the Andersons borrowed the dividends back, executing promissory notes. The stock certificates and notes remained in the corporate office. In 1940, the Andersons reacquired the stock, issuing new notes, with an understanding regarding future payment. The Andersons continued to manage the corporation as before. The Tax Court held that the stock transfers were not bona fide gifts and that the dividends were taxable to the Andersons because they retained control and benefit from the stock and dividends.

Facts

Ralph and Herbert Anderson, brothers, owned a majority of the stock in Robert R. Anderson Co. In December 1937, and April 1938 and 1939, they transferred shares to their wives and children just before dividend declarations. After the dividends were paid, the Andersons borrowed the dividend amounts back from the transferees, issuing promissory notes. The stock certificates and promissory notes were kept in the company safe in the care of a company employee. The Andersons continued to manage the company without formal stockholder meetings. In 1940, the stock was transferred back to Ralph and Herbert and their wives.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Ralph and Herbert Anderson's income tax for 1939 and 1940, arguing the dividends paid on the transferred stock should be taxed to them. The Andersons petitioned the Tax Court for review. The Tax Court consolidated the cases.

Issue(s)

Whether the transfers of stock from Ralph and Herbert Anderson to their family members constituted bona fide gifts, such that the dividends paid on the stock should be taxed to the recipients rather than the donors?

Holding

No, because the petitioners did not relinquish control over the stock or the dividends, and the transfers lacked economic substance, indicating that they were primarily motivated by tax avoidance.

Court’s Reasoning

The court emphasized that while the legal forms of a gift were present (competent donors and donees, transfer on corporate records), the substance of the transactions indicated a lack of intent to relinquish control. Key factors included: the timing of the transfers just before dividend declarations; the immediate borrowing back of the dividends; the retention of the stock certificates and notes in the company’s safe under the Andersons’ control; the free endorsement of dividend checks; the use of dividend funds by the Andersons; the later instruction to destroy the notes; and the reacquisition of the stock. The court stated, “Looking for a moment, as we must, at the substance and practical effect of the series of transfers, we can not ignore the fact that, although the legal forms were properly executed in every case, the two petitioners who previously owned the stock, and through whose personal efforts the money was earned, continued after the transfers as before to exercise the prerogatives of stockholders in their exclusive management and control of the corporation, and continued to have the use and enjoyment of the dividends earned on exactly the same number of shares which each had previously owned.” The court concluded that these facts demonstrated a lack of genuine intent to make a gift and that the petitioners had failed to prove the Commissioner’s determination was in error.

Practical Implications

This case illustrates the importance of substance over form in determining the validity of gifts for tax purposes, particularly within family contexts. Courts scrutinize intra-family transactions for indicia of retained control or benefits by the donor. Attorneys advising clients on gifting strategies must ensure that the donor genuinely relinquishes control and that the donee exercises true ownership rights. The case warns against arrangements where the donor continues to benefit from the gifted property, as these may be recharacterized as shams by the IRS. Later cases cite Anderson for the proposition that continued dominion and control by the donor is a key factor in determining whether a gift is bona fide.

