7 T.C. 12 (1946)

The fair market value of a gift made in foreign currency subject to governmental restrictions on its transfer is determined by taking those restrictions into account, not by the official exchange rate for unrestricted currency.

Summary

Morris Marks Landau, a resident alien, made a gift of South African pounds held in a South African firm to a trust for his children and grandchildren. Due to Emergency Finance Regulations imposed by the Union of South Africa, these pounds were blocked and could not be freely transferred. Landau valued the gift at a restricted rate ($2/pound) while the IRS used the official exchange rate ($3.98/pound). The Tax Court held that the gift's value should reflect the restrictions on the currency, accepting Landau's valuation because the pounds were blocked and their transferability was severely limited.

Facts

- Landau, a British citizen residing in California, had funds in a South African firm.
- The Union of South Africa imposed Emergency Finance Regulations in 1939, restricting the transfer of currency out of the country.
- In 1941, Landau executed a power of attorney to transfer 27,500 South African pounds from his account to a trust for his children and grandchildren.
- These pounds were "blocked" and subject to restrictions on their use and transfer. Landau could not freely convert them to US dollars.
- Landau valued the gift at $2 per pound on his gift tax return, while the Commissioner used the official exchange rate of $3.98 per pound.

Procedural History

The Commissioner of Internal Revenue determined a gift tax deficiency based on the higher valuation of the South African pounds. Landau petitioned the Tax Court, contesting the Commissioner's valuation. The Tax Court ruled in favor of Landau, finding that the restricted value of the pounds should be used for gift tax purposes.

Issue(s)

1. Whether the fair market value of a gift made in foreign currency that is subject to governmental restrictions on transfer should be determined using the official exchange rate or by taking into account the restrictions.

Holding

1. No, because the value of the property should be determined by taking into account the governmental restrictions that limit the transferability and use of

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the currency.

Court’s Reasoning

The Tax Court reasoned that the fair market value of the gift should reflect the actual economic benefit conferred upon the donees, considering the restrictions imposed by the South African government. The court emphasized that the official exchange rate applied only to “free pounds,” while the pounds in question were “blocked” and subject to significant limitations. The court cited *Eder v. Commissioner*, 138 F.2d 27, which held that blocked currency should not be valued at the free exchange rate. The court noted that expert testimony indicated that the value of restricted South African pounds in the United States was significantly lower than the official exchange rate. The court stated, “Under such circumstances we think the value of the property should be determined by taking into account the governmental restrictions.”

Practical Implications

This case establishes that when valuing gifts (and potentially other transfers) made in foreign currency, the existence of governmental restrictions on the currency’s transfer or use must be considered. The official exchange rate is not determinative if the currency is blocked or otherwise encumbered. This ruling impacts tax planning for individuals holding assets in countries with currency controls. Attorneys must investigate whether currency is freely transferable before advising clients on the tax implications of gifts or bequests involving foreign assets. Later cases and IRS guidance would need to be consulted to determine if specific valuation methods have been prescribed for similar scenarios, but the core principle remains: restrictions impact value.

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