12 T.C. 1072 (1949)

A tax exemption will not apply when a series of transactions, while technically meeting the exemption's requirements, are undertaken solely for the purpose of avoiding tax, lacking any independent business or functional significance.

Summary

Jeanne H. Lewinon, a French citizen fleeing Nazi persecution, temporarily resided in the United States. Prior to making gifts to trusts, she converted domestic stocks and bonds into U.S. Treasury notes, which were generally exempt from gift tax for nonresident aliens. The Tax Court held that despite Lewinon's nonresident alien status, the gift tax applied because the conversion to Treasury notes was solely to avoid taxes and lacked any independent business purpose. The court relied on the integrated transaction doctrine, finding the conversion and gift were interdependent steps in a single plan.

Facts

Jeanne H. Lewinon, a French citizen, fled France due to Nazi persecution and entered the U.S. in October 1940 on a temporary visitor visa with the stated intention of traveling to Argentina. Her visa required her to leave the U.S. by March 16, 1941. She expressed her intention to return to France to friends and family. In January 1941, Lewinon sold her U.S. stocks and bonds and purchased U.S. Treasury notes, acting on advice to avoid gift tax. In February 1941, Lewinon created trusts for her relatives, funding them with the newly acquired Treasury notes. She took preliminary steps to explore entering the U.S. as a quota immigrant from Canada, indicating some uncertainty about her long-term plans.

Procedural History

The Commissioner of Internal Revenue assessed a gift tax deficiency. Lewinon's estate (she having since died) petitioned the Tax Court for a redetermination, arguing she was a nonresident alien and the gifts consisted of tax-exempt U.S. Treasury notes and that she was entitled to a $40,000 specific exemption. The Tax Court ruled against the estate.

Issue(s)

1. Whether Lewinon was a nonresident alien not engaged in business in the United States at the time the gifts were made.
2. If so, whether the property transferred by gift consisted of bonds, notes, or certificates of indebtedness of the United States, thus making the gifts exempt from gift tax under the provisions of Title 31, United States Code Annotated, § 750.
3. Whether, as a nonresident alien, Lewinon was entitled to the $40,000 specific exemption.

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Holding

1. Yes, Lewinon was a nonresident alien because she intended to return to France as soon as conditions permitted, maintaining her domicile there.
2. No, the gifts were not exempt because the acquisition of the Treasury notes was solely to avoid gift taxes and lacked a functional or business purpose apart from the transfers by gift.
3. No, nonresident aliens are not entitled to the $40,000 specific exemption because that exemption applies to residents only.

Court's Reasoning

The court determined Lewinon was a nonresident alien based on her temporary visa, her stated intention to return to France, and the fact that she was fleeing persecution with the intent to return home. However, relying on *Pearson v. McGraw*, 308 U.S. 313 (1939), the court applied the integrated transaction doctrine. The court reasoned that Lewinon's conversion of domestic stocks and bonds into U.S. Treasury notes was part of a single, integrated transaction designed to avoid gift tax. The court emphasized that "the mere sale of the intangibles and the acquisition of the federal reserve notes had no functional or business significance apart from the…transfer." Lewinon's actions were a prearranged program to make a tax-exempt gift, rendering the conversion ineffectual for tax purposes. The court also held that the $40,000 specific exemption was only available to U.S. residents.

Practical Implications

This case reinforces the principle that tax exemptions are not absolute and can be denied if the underlying transaction lacks economic substance beyond tax avoidance. It demonstrates the application of the step transaction doctrine (also known as the integrated transaction doctrine) in gift tax cases. Attorneys must advise clients that converting assets into exempt forms immediately before a gift, solely to avoid tax, is unlikely to succeed. This case cautions against artificial transactions lacking a business purpose. Subsequent cases applying this ruling analyze whether a series of transactions have independent economic significance or are merely steps in an integrated plan to avoid taxation. It also underscores the importance of documenting legitimate business or investment reasons for asset conversions to support a claim for tax exemption.

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