Robert B. Gardner Trust, 14 T.C. 1445 (1950)</p>

When a property transfer is made as part of a divorce settlement, the transfer is considered a sale, not a gift, for tax purposes, meaning the recipient's basis in the property is its fair market value at the time of transfer.

Summary</p>

The case addressed the determination of the cost basis of stock held in a trust created by Robert B. Gardner. The IRS argued that the stock was a gift, meaning the trust's basis in the stock should be the same as the original cost to the donor. The Tax Court held that the transfer of stock to the trust as part of a divorce settlement was not a gift but a purchase, since the transfer was made in exchange for the wife's release of her marital rights. Therefore, the trust's basis in the stock was its fair market value at the time of the transfer, and not the husband's original cost basis. The decision focused on the substance of the transaction, emphasizing that the transfer was part of an arm's-length agreement incident to a divorce, rather than a gratuitous gift. This directly impacted the calculation of capital gains when the stock was later sold.

Facts</p>

Robert B. Gardner transferred stock to a trust for his wife, Edna W. Gardner, in 1921. The transfer occurred as part of a property settlement in contemplation of a divorce. The trust agreement used the phrase "voluntary gift." Subsequently, the stock was redeemed in 1943. The primary issue before the court was determining the proper cost basis of this stock for tax purposes. If it was a gift, the basis would be the donor's original cost. If it was a purchase, the basis would be the fair market value at the time of the transfer. The parties stipulated that the cost basis of the redeemed stock hinged on whether the original transfer to the trust constituted a gift or a purchase.

Procedural History</p>

The case originated in the United States Tax Court. The Commissioner of Internal Revenue determined the basis of the stock, leading the petitioner to challenge this determination. The Tax Court was the initial and final decision-maker on the matter as it concerned federal tax law.

Issue(s)</p>

1. Whether the transfer of stock to the trust by Robert B. Gardner was a gift or a purchase?

Holding</p>

1. No, because the transfer of stock was made as part of a property settlement in

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anticipation of a divorce and in exchange for the wife’s release of her marital rights, it was considered a purchase rather than a gift.

Court’s Reasoning</p>

The court focused on the substance of the transaction rather than the form. The phrase “voluntary gift” in the trust document did not control the characterization of the transfer. The court cited "In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding." The court reasoned that the transfer was part of an arm’s-length property settlement between divorcing parties. The wife released her marital rights in exchange for the stock. The court distinguished this situation from a simple gift between spouses. The decision relied heavily on the factual context of the divorce settlement. Because of this exchange, the transfer was treated as a purchase for tax purposes.

Practical Implications</p>

This case is crucial in determining the tax consequences of property transfers in divorce settlements. It establishes that such transfers are generally treated as sales for tax purposes rather than gifts. This means the recipient of the property takes a basis equal to the fair market value of the property at the time of the transfer. This impacts the calculation of capital gains or losses upon subsequent sale. Attorneys must carefully document the nature of property settlements in divorce proceedings. The court will examine the intent of the parties and the consideration exchanged. This case emphasizes that substance prevails over form. Any language in agreements that suggests a gift will be scrutinized in light of the overall circumstances. This ruling influences advice given to clients during divorce negotiations, impacting tax planning strategies, and guiding how property settlements are structured to minimize tax liabilities. Later courts frequently cite the case when examining property transfers occurring during divorce proceedings.

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