33 T.C. 660 (1960)

When a business is acquired by gift, the donee's basis for assets received, including uncompleted work, is the donor's basis (or fair market value at the time of the gift) plus any consideration paid, allocated based on the relative value of each asset to the whole business.

Summary

The case concerns the tax implications of a business acquired through a gift. The petitioner, Wren Bowyer, received a directory publishing business from the estate of his friend. The issue was whether income from the sale of uncompleted directories was taxable to Bowyer, and if so, how to determine the basis for calculating the taxable gain. The court held that the business was received by gift, making the donor's basis (fair market value at the time of the gift) the relevant basis. The court determined that a portion of the business's overall value should be allocated to the uncompleted directories, thereby establishing a basis for calculating the taxable income from their sale.

Facts

J.H. (Jack) Foreman owned the Business Directory Service, which published and sold an annual city directory. Foreman died, and his daughter, the sole beneficiary, assigned the business to Bowyer, as per Foreman's wishes. The assignment included good will, accounts receivable, furniture and fixtures, cuts and printing materials, and all personal property connected with the business. Bowyer paid state inheritance and federal estate taxes related to the business's inclusion in the estate. At the time of the gift, the printer had nearly completed 1,200 copies of the 1953 directory. Bowyer received $28,361.52 from directory sales and advertising revenue in 1953, but did not include any portion of this in his gross income. The IRS determined a deficiency based on the sale of the directories.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Bowyer's income tax for 1952 and 1953. Bowyer disputed the determination regarding the 1953 tax year, arguing the proceeds from the sale of directories were not taxable. The U.S. Tax Court heard the case and issued a decision.

Issue(s)

1. Whether the transfer of the directory business to Bowyer constituted a gift.

2. If the transfer was a gift, what was Bowyer's basis in the uncompleted directories for the purpose of calculating income?

Holding

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1. Yes, the transfer of the business to Bowyer was a gift because the daughter expressed donative intent, and Bowyer's agreement to pay existing business obligations did not prevent the transfer from being a gift.

2. Bowyer's basis in the unfinished directories should be a portion of the value of the business at the time of the gift, allocated based on the relative value of each item, plus the partial consideration he paid (estate and inheritance taxes).

Court's Reasoning

The court first addressed whether the transfer was a gift. It found the daughter intended to give the business, and Bowyer's assumption of some of the business's obligations did not negate the gift because the obligations were not burdensome and did not constitute substantial consideration. The court cited *Commissioner v. Ehrhart* to support the idea that a transfer of property is not kept from being a gift by payment of nominal consideration. The court then determined that Bowyer's basis in the assets he received (the unfinished directories) was the donor's basis, which was the fair market value of the business at the time of the gift, plus any consideration paid by the donee, which in this case were the taxes. The court emphasized that Bowyer had to show the fair market value and allocate a portion of the value to the unfinished directories, rather than the IRS's zero allocation or Bowyer's argument that the full value should be applied to the directories. The court then allocated $3,000 as the basis for the 1953 directories. As the court stated: "We are of the opinion petitioner received the entire going business, called the Business Directory Service, by gift…" and "The allocation of that fair market value and cost basis, or $ 25,660.51, among the several properties acquired should be based upon the relative value of each item to the value of the whole."

Practical Implications

This case is important for its practical guidance on business transfers via gift. It establishes that when a business is transferred as a gift, the donee takes the donor's basis in the assets. However, a determination of the correct basis requires allocating the overall fair market value of the business (at the time of the gift) across its individual assets. The court's approach of allocating the basis based on relative value has implications for valuation and tax planning in similar transactions. It also serves as a reminder that when the donee takes on certain obligations related to the business, that does not necessarily preclude the transfer from being classified as a gift.

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