Legg v. Commissioner, 57 T. C. 164 (1971)

Transfer of an installment obligation to a trust constitutes a taxable disposition, and a charity is not publicly supported if it receives contributions from a limited number of sources.

Summary

In Legg v. Commissioner, the petitioners sold an apple orchard and elected installment reporting. They then transferred the installment obligation to an irrevocable trust, retaining the right to receive annual payments, with the remainder to a charitable foundation. The court held that this transfer was a taxable disposition under section 453(d), requiring recognition of the obligation's fair market value. Additionally, the court found the foundation was not publicly supported, limiting the petitioners' charitable deduction to 20% of their adjusted gross income without a carryover, and the annual payments were deemed interest, not an annuity.

Facts

The Leggs sold a 30-acre apple orchard to Wells & Wade Fruit Co. for $140,000, with $20,000 down and the balance payable upon their death, electing to report the gain on an installment basis. Simultaneously, they transferred the installment sales contract to an irrevocable trust, retaining the right to receive $6,000 annually (equivalent to the contract's interest) during their lifetimes, with the remainder interest designated for the A. Z. Wells Foundation. The foundation, created under A. Z. Wells' will, was primarily funded by future interests from a few similar transactions.

Procedural History

The Commissioner determined deficiencies in the Leggs' income taxes for the fiscal years ending June 30, 1965, and June 30, 1966. The Tax Court reviewed the case, focusing on the disposition of the installment obligation, the public support status of the foundation, and the nature of the annual payments received by the Leggs.

Issue(s)

1. Whether the transfer of the installment sales contract to the trust constitutes a disposition under section 453(d)?
2. Whether the A. Z. Wells Foundation is publicly supported under section 170(b)(1)(A), affecting the Leggs' charitable deduction and carryover?
3. Whether the $6,000 annual payment received by the Leggs from the trust is an annuity or interest?

Holding

1. Yes, because the transfer of the installment obligation to the trust was an

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irrevocable disposition of the principal interest under section 453(d), requiring the recognition of gain based on the obligation's fair market value.
2. No, because the foundation was not publicly supported within the meaning of section 170(b)(1)(A), limiting the Leggs' charitable deduction to 20% of their adjusted gross income without a carryover.
3. No, because the $6,000 annual payment was interest, not an annuity, as it was merely a pass-through of the interest from the original contract.

Court's Reasoning

The court determined that transferring the installment obligation to the trust was a disposition under section 453(d), citing the legislative intent to prevent tax evasion through such transfers. The court rejected the Leggs' arguments that the trust should be treated as a grantor trust or that the transaction's form should be ignored. The fair market value of the obligation was set at $75,000, considering the orchard's hazardous nature and the contract's terms. Regarding the foundation, the court found it was not publicly supported as required by section 170(b)(1)(A) due to its reliance on a few future interest contributions, which did not align with Congress's intent to encourage immediate, broad-based public support. The annual payments were classified as interest, not an annuity, as they directly corresponded to the interest payments under the original sales contract.

Practical Implications

This decision clarifies that transferring an installment obligation to a trust triggers immediate tax recognition under section 453(d), impacting estate planning and charitable giving strategies. It also sets a precedent for evaluating a charity's public support status, focusing on the number and immediacy of contributions rather than their value. Tax practitioners must carefully structure transactions involving installment sales and charitable trusts to avoid unintended tax consequences. Subsequent cases have applied this ruling to similar scenarios, reinforcing the need for clear delineations between income and principal interests in trust arrangements.

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