S. C. Johnson & Son, Inc. v. Commissioner, 63 T. C. 778 (1975)

A taxpayer does not realize taxable income upon assigning appreciated property to a charity if no fixed right to income exists at the time of the assignment.

Summary

S. C. Johnson & Son, Inc. assigned two appreciated foreign exchange contracts to its charitable fund, Johnson's Wax Fund, Inc. , which later sold them. The IRS argued that Johnson realized taxable income from the contracts' appreciation before the assignment. The Tax Court held that no taxable income was realized because Johnson had no fixed right to the income at the time of the gift. The contracts were appreciated property, and the gain was not 'earned' or 'vested' until after the assignment. This ruling clarifies that a mere expectation of income from appreciated property does not trigger immediate taxation upon its charitable donation.

Facts

S. C. Johnson & Son, Inc. (Johnson) entered into forward sale contracts with two banks in July 1967 to sell British pounds in July 1968. After the November 1967 devaluation of the pound, these contracts appreciated in value. In April 1968, Johnson assigned these contracts to its charitable organization, Johnson's Wax Fund, Inc. (Wax Fund). The Wax Fund sold the contracts in May 1968, realizing a gain. Johnson claimed a charitable deduction for the value of the contracts at the time of the assignment. The IRS determined Johnson realized unreported taxable income from the contracts' disposition.

Procedural History

The IRS issued a notice of deficiency to Johnson for the fiscal years ending June 30, 1967, and June 28, 1968, asserting that Johnson realized unreported income from the contracts' disposition. Johnson petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court heard the case and issued its opinion in 1975.

Issue(s)

1. Whether Johnson realized unreported income from the assignment of the appreciated foreign exchange contracts to the Wax Fund.
2. Whether any income realized from the contracts' subsequent sale by the Wax Fund would be taxable as ordinary income or capital gain.

Holding

1. No, because Johnson did not have a fixed right to the income at the time of the assignment. The contracts were appreciated property, and the potential income was not earned or vested until after the assignment.
2. The court did not need to decide this issue due to its ruling on the first issue.

Court's Reasoning

The court applied the principle that a taxpayer does not realize income from the assignment of appreciated property to a charity unless a fixed right to that income exists at the time of the assignment. The court distinguished between earned income and appreciated property, citing cases like Humacid Co. and Campbell v. Prothro. It emphasized that Johnson had not taken steps to close out the contracts or lock in the gain before the assignment. The court rejected the IRS's argument that the gain was "in the bag," noting that the potential income was not assured and could have been affected by currency fluctuations. The court also considered the separate legal status of Johnson and the Wax Fund, finding no evidence of overreaching or failure to protect the Wax Fund's interests. The court concluded that Johnson did not realize taxable income upon the assignment or the Wax Fund's subsequent sale of the contracts.

Practical Implications

This decision clarifies that taxpayers can donate appreciated property to charities without realizing immediate taxable income if no fixed right to the income exists at the time of the gift. It emphasizes the importance of distinguishing between appreciated property and earned income in tax planning. Practitioners should advise clients to carefully structure charitable donations of appreciated property to avoid triggering immediate taxation. The ruling also reinforces the legal separation between a company and its charitable fund, even when controlled by the same individuals. Subsequent cases have applied this principle to various types of appreciated property, such as stock and real estate. Taxpayers and their advisors should consider this case when planning charitable contributions involving assets that may appreciate in value.

