Knott v. Commissioner, 67 T. C. 681 (1977)

Corporate bargain sales of property to a charitable foundation can qualify as charitable contributions if the transfer is voluntary and made without expectation of personal benefit.

Summary

In Knott v. Commissioner, the Tax Court ruled that Severn River Construction Co. and its subsidiaries could claim charitable contribution deductions for selling real estate to the Knott Foundation at below market value. The court found that these transactions were genuine charitable contributions, not constructive dividends to the company's shareholders, the Knotts. This decision hinged on the absence of personal benefit to the Knotts and the charitable intent behind the transfers. The case clarifies that even without formal corporate documentation, a bargain sale can be recognized as a charitable contribution if the underlying intent is charitable and there is no anticipated personal gain.

Facts

Henry J. and Marion I. Knott, sole shareholders of Severn River Construction Co. and its subsidiaries, sold four parcels of real estate to the Henry J. and Marion I. Knott Foundation at prices significantly below fair market value. The sales occurred in 1967 and 1969, with the properties being leased back to Henry Knott for development into apartment complexes. The Knotts had a history of significant charitable activities and contributions. No formal corporate resolutions or charitable contribution deductions were recorded for these transactions, and the foundation's tax-exempt status had been previously challenged due to similar transactions.

Procedural History

The IRS assessed deficiencies against the Knotts and Severn for the tax years 1968 and 1969, treating the real estate sales as constructive dividends. The Knotts and Severn contested this in the Tax Court, arguing the sales were charitable contributions. The court heard the case and ruled in favor of the petitioners, allowing the charitable contribution deductions.

Issue(s)

1. Whether the sales of real estate by Severn and its subsidiaries to the Knott Foundation at below market value constituted charitable contributions or constructive dividends to the Knotts.
2. Whether the absence of formal corporate documentation and reporting as charitable contributions on tax returns precludes recognition of these transactions as charitable contributions.

Holding

1. Yes, because the sales were voluntary transfers made without expectation of personal benefit to the Knotts, fulfilling the criteria for charitable contributions.
2. No, because the lack of formal documentation does not negate the charitable intent and the transactions' substance as charitable contributions.

Court's Reasoning

The court applied the definition of a "gift" from Harold DeJong, which requires a voluntary transfer without consideration and no anticipated benefit beyond the act of giving. The Knotts' long history of charitable giving and their lack of personal benefit from the transactions supported the court's finding of charitable intent. The court dismissed the IRS's argument that the absence of formal corporate minutes and tax reporting as charitable contributions invalidated the charitable nature of the transactions, noting that the Knotts and their advisors were concerned about jeopardizing the foundation's exempt status. The court also distinguished the case from precedents cited by the IRS, such as Schalk Chemicals, Harry L. Epstein, and Challenge Manufacturing, where personal benefits to shareholders were evident. The court emphasized that the Knotts did not receive any financial benefits from the transactions, and the foundation used the properties to generate income for charitable purposes.

Practical Implications

This decision provides guidance for corporations and their shareholders in structuring bargain sales to charitable organizations. It establishes that such transactions can be treated as charitable contributions even without formal documentation, provided there is genuine charitable intent and no personal benefit to the shareholders. Legal practitioners should advise clients on the importance of documenting charitable intent and the potential tax implications of bargain sales to charities. The ruling may encourage more corporate donations to charities through bargain sales, as it clarifies the conditions under which such transactions can be deductible. Subsequent cases have referenced Knott in analyzing the tax treatment of corporate donations to charities, particularly in situations where the corporate structure and shareholder involvement are similar.