Guest v. Commissioner, 77 T. C. 9 (1981)

A charitable contribution of property subject to a nonrecourse mortgage is treated as a sale or exchange to the extent the mortgage exceeds the donor's adjusted basis, resulting in taxable gain.

Summary

Winston F. C. Guest donated real properties encumbered by nonrecourse mortgages exceeding his adjusted bases to a temple. The temple sold the properties and directed Guest to deed them directly to the buyers. The Tax Court ruled that the contribution was a completed gift in 1970 when the deeds were executed, and a taxable 'sale or exchange' to the extent the mortgages exceeded Guest's adjusted bases. The court determined Guest's adjusted basis for calculating gain and his charitable deduction based on the properties' fair market value at the time of the gift.

Facts

Winston F. C. Guest purchased the Sandringham and Aberdeen properties in 1959, paying $67,500 and taking them subject to $2,989,000 in nonrecourse mortgages. The properties generated minimal net cash flow. In December 1969, Guest offered these properties as a charitable gift to Temple Emanu-el of Yonkers. The temple accepted the gift but requested Guest retain title as its nominee to avoid transfer taxes. The temple then sold the properties, with the Aberdeen Properties sold to the Kallman group for $5,000 and the Sandringham Properties transferred to Korn Associates without consideration to the temple. Deeds were executed and delivered on April 10, 1970.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Guest's income tax for 1968-1970. Guest challenged these determinations in the U. S. Tax Court, which ruled in 1981 that the charitable contribution was completed in 1970 when the deeds were executed, and that Guest realized taxable gain to the extent the mortgages exceeded his adjusted bases in the properties.

Issue(s)

1. Whether Guest made a completed gift of the properties to the temple or a gift of the proceeds from their sale.
2. Whether the charitable contribution was made in 1969 or 1970.
3. Assuming a gift of the properties was made, whether Guest realized gain to the extent the outstanding mortgages exceeded his adjusted bases, and the amount of the charitable contribution deduction.

Holding

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1. Yes, because Guest's actions and communications clearly indicated his intent to donate the properties themselves, not their proceeds, and he executed deeds to the temple's designees as instructed.
2. No, because the deeds were not executed and delivered until April 10, 1970, not in 1969 as Guest failed to prove.
3. a. Yes, because the transfer of property subject to nonrecourse debt exceeding the adjusted basis constitutes a taxable 'sale or exchange' under the Crane doctrine, resulting in gain equal to the excess.
b. Guest's charitable deduction was $30,000, as determined by the court based on the properties' fair market value at the time of the gift.

Court's Reasoning

The court applied the Crane doctrine, which holds that nonrecourse liabilities must be included in the 'amount realized' upon disposition of property. The court reasoned that Guest's donation of the properties constituted a 'sale or exchange' to the extent the mortgages exceeded his adjusted bases, preventing a double deduction for depreciation. The court also determined that the gift was completed in 1970 when the deeds were executed and delivered to the temple's designees. The court valued the properties at $30,000 based on the evidence presented, despite the parties' conflicting valuations. The court's decision was supported by prior cases like Johnson v. Commissioner and Freeland v. Commissioner, which treated similar transfers as taxable events.

Practical Implications

This decision clarifies that donating property subject to nonrecourse debt exceeding the adjusted basis results in taxable gain, even if the donation is to a charity. Taxpayers must carefully consider the tax implications of such gifts, as they may trigger unexpected tax liabilities. The ruling reinforces the Crane doctrine's broad application to all dispositions of property, not just sales. Practitioners should advise clients to value properties accurately at the time of the gift and consider the tax consequences of nonrecourse debt. Subsequent cases have followed this precedent, and it remains a key consideration in structuring charitable contributions of encumbered property.

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