Gershman Family Foundation v. Commissioner, 83 T. C. 217 (1984)

A transfer of property to a private foundation is considered self-dealing if the property is subject to a lien, even if the lien does not directly encumber the transferred asset.

Summary

In Gershman Family Foundation v. Commissioner, the court addressed whether transferring a promissory note and deed of trust to a private foundation constituted self-dealing under the Internal Revenue Code. Harold Gershman transferred a note secured by an all-inclusive deed of trust (AITD) to his foundation, which was subject to senior notes. The court ruled that this transfer was an act of self-dealing because the transferred note was subject to a lien created by the senior notes, despite not being directly encumbered by them. The case highlights the broad interpretation of what constitutes a lien in the context of self-dealing, emphasizing the need for careful consideration of all encumbrances when dealing with private foundations.

Facts

In 1971, Harold Gershman sold an apartment building and received a promissory note secured by an all-inclusive deed of trust (AITD). The property was already encumbered by two senior notes. An addendum to the AITD allowed the obligor to offset payments against the senior notes. In 1972, Gershman established a private foundation, making him a disqualified person under IRC Sec. 4941. In 1973, he transferred the promissory note and AITD to the foundation. The obligor defaulted in 1974, leading to the property's reassignment to Gershman, who issued a note to the foundation.

Procedural History

The case began with the Commissioner assessing excise taxes against the Gershman Family Foundation and Harold Gershman for alleged acts of self-dealing. The petitioners and respondent filed cross-motions for partial summary judgment in the U. S. Tax Court regarding the 1973 and 1974 transactions. The court granted the petitioners' motion regarding the 1973 transfer but denied both motions regarding the 1974 transactions due to unresolved factual issues.

Issue(s)

1. Whether the 1973 transfer of the promissory note and AITD to the foundation constituted an act of self-dealing under IRC Sec. 4941(d)?
2. Whether the 1974 transactions constituted correction of the 1973 act of self-dealing or were separate acts of self-dealing?

Holding

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1. Yes, because the transferred property was subject to a lien created by the senior notes, even though it did not directly encumber the note itself.
2. Undecided, because factual issues remain as to whether the 1974 transactions corrected the 1973 act of self-dealing or constituted new acts of self-dealing.

Court’s Reasoning

The court interpreted the phrase “subject to” in IRC Sec. 4941(d)(2)(A) broadly, focusing on the substance of the transaction rather than its form. The court found that the addendum to the AITD created a lien on the promissory note, as it allowed the obligor to offset payments due on the senior notes against the note. This interpretation was supported by the legislative intent to prevent self-dealing and the court’s reference to the arm’s-length standards of prior law. The court rejected the respondent’s argument that the lien only applied to the real property, emphasizing that the transferred note carried the risk of the obligor claiming offsets or prepaying the senior notes, shifting this risk to the foundation and benefiting Gershman personally. The court also noted that factual issues regarding the value of the AITD and the nature of the 1974 transactions precluded summary judgment on the second issue.

Practical Implications

This decision underscores the importance of considering all potential liens or encumbrances when transferring property to a private foundation. Attorneys and taxpayers must carefully review any agreements or addendums that may create indirect liens on transferred assets. The case also highlights the need for clear documentation and valuation of assets in transactions involving private foundations to avoid allegations of self-dealing. Subsequent cases have applied this broad interpretation of “subject to” in various contexts, reinforcing the need for vigilance in transactions with private foundations. This ruling may affect how businesses and individuals structure their dealings with private foundations, potentially leading to more conservative approaches to avoid unintended self-dealing.

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