Estate of Edward S. Redstone, Deceased, Madeline M. Redstone, Executrix v. Commissioner of Internal Revenue, 145 T. C. 259 (United States Tax Court, 2015)

The U. S. Tax Court ruled in favor of the Estate of Edward S. Redstone, determining that Edward's transfer of National Amusements, Inc. (NAI) stock to trusts for his children was not a taxable gift. The court found the transfer was made in the ordinary course of business as part of a settlement resolving a family dispute over stock ownership. This decision clarifies that transfers made in settlement of bona fide disputes can be exempt from gift tax, even if the consideration does not come directly from the transferees.

Parties

The petitioner was the Estate of Edward S. Redstone, with Madeline M. Redstone serving as the executrix. The respondent was the Commissioner of Internal Revenue.

Facts

Edward S. Redstone was part of the Redstone family business, which was reorganized into National Amusements, Inc. (NAI) in 1959. Upon NAI's incorporation, Edward, his father Mickey, and his brother Sumner were each registered as owners of one-third of NAI's shares, despite contributing disproportionate amounts of capital. Edward left the business in 1971 and demanded all his stock, which Mickey refused to deliver, asserting that a portion was held in an oral trust for Edward's children due to the disproportionate contributions at NAI's inception. After negotiations and litigation, a settlement was reached in 1972 where Edward transferred one-third of the disputed shares into trusts for his children, Michael and Ruth Ann. In exchange, Edward was acknowledged as the outright owner of the remaining two-thirds of the shares, which NAI redeemed for $5 million.

Procedural History

The Commissioner determined a gift tax deficiency against Edward's estate for the 1972 transfer of NAI stock to trusts for his children. The estate petitioned the U. S. Tax Court for a redetermination of the deficiency. The court's decision was made under a de novo standard of review, considering the evidence presented by both parties.

Issue(s)

Whether Edward S. Redstone's transfer of NAI stock to trusts for his children was made in the ordinary course of business and for a full and adequate consideration in money or money's worth, thus exempting it from gift tax under 26 U. S. C. § 2512(b) and 26 C. F. R. § 25. 2511-1(g)(1)?

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Rule(s) of Law

The Federal gift tax, as per 26 U. S. C. § 2501(a)(1), is imposed on the transfer of property by gift. However, under 26 U. S. C. § 2512(b), a transfer for less than adequate and full consideration in money or money's worth is deemed a gift. The Treasury Regulations specify that the gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth or to ordinary business transactions, as stated in 26 C. F. R. § 25. 2511-1(g)(1). A transfer is considered to be in the ordinary course of business if it is bona fide, at arm's length, and free from any donative intent, as per 26 C. F. R. § 25. 2512-8.

Holding

The U. S. Tax Court held that Edward S. Redstone's transfer of NAI stock to trusts for his children was made in the ordinary course of business and for a full and adequate consideration in money or money's worth, namely, the recognition by Mickey and Sumner that Edward was the outright owner of two-thirds of the disputed shares and NAI's payment of $5 million in exchange for those shares. Therefore, the transfer was not subject to the Federal gift tax.

Reasoning

The court analyzed the transfer under the three criteria specified in 26 C. F. R. § 25. 2512-8 for determining whether a transaction is in the ordinary course of business: (1) the transfer must be bona fide, (2) transacted at arm's length, and (3) free of donative intent. The court found that the transfer met all three criteria:

– **Bona Fide:** The transfer was a bona fide settlement of a genuine dispute between Edward and his father over stock ownership. The court noted the evidence showed no collusion between the parties and that the dispute was not a sham to disguise a gratuitous transfer.

– **Arm's Length:** The court found that the transfer was made at arm's length, as Edward acted on the advice of counsel and engaged in adversarial negotiations with Mickey and Sumner. The settlement was incorporated into a judicial decree, further supporting the arm's-length nature of the transaction.

– **Absence of Donative Intent:** The court determined that Edward's transfer was not motivated by love and affection but was forced upon him by Mickey as a condition for settling the dispute and receiving payment for the remaining shares. Edward's objective was to secure ownership or payment for all 100 shares originally registered in his name.

The court rejected the Commissioner's argument that the transfer was a gift because Edward's children did not provide consideration. The court reasoned that the regulations focus on whether the transferor received adequate consideration, not the source of that consideration. The court cited *Shelton v. Lockhart*, 154 F.

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Supp. 244 (W. D. Mo. 1957), where a similar transfer was held not to be a gift despite the consideration coming from a third party rather than the transferees.

Disposition

The U. S. Tax Court entered a decision for the petitioner, the Estate of Edward S. Redstone, finding no deficiency in Federal gift tax for the period at issue and no liability for any additions to tax.

Significance/Impact

This decision clarifies the application of the ordinary course of business exception to the Federal gift tax, particularly in the context of family disputes and settlements. It establishes that transfers made as part of bona fide settlements can be exempt from gift tax, even if the consideration does not come directly from the transferees. The ruling may impact future cases involving similar family business disputes and the taxation of settlement agreements. It also underscores the importance of the three criteria specified in the Treasury Regulations for determining whether a transaction is in the ordinary course of business.

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