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Issue Contents

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HOW NOT TO MAKE GIFTS

— by Neil E. Harl[*]

Although the promise of a new income tax basis at death[1] (and other factors) tend to discourage gift making during life, those with larger estates are sometimes motivated to make inter vivos gifts anyway.[2] A 2000 Seventh Circuit Court of Appeals case[3] has painted a clear picture as to how it should not be done.

Facts in *Estate of Stinson*

In *Estate of Stinson v. United States*,[4] the grandmother (the decedent) in 1981 sold 267 acres of farmland to a family-owned corporation for $398,728 to be paid over 20 years. From 1982 to 1985, the decedent forgave $147,000 in principal indebtedness (which was roughly $10,000 more than the principal payments due under the contract).[5] The land was sold in 1990 and the corporation was dissolved.[6]

After the decedent's death, the Internal Revenue Service audited the estate and determined that the forgiveness of indebtedness did not qualify for the $10,000 per donee federal gift tax annual exclusion.[7] Both the statute[8] and the regulations[9] specify that only present interests are eligible for the federal gift tax annual exclusion. The question is whether a gift to a corporation is an indirect gift to the shareholders who can use or enjoy the gift only through liquidation of the corporation or declaration of a dividend or whether the gift is deemed immediately enjoyable by the shareholder (through an increase in their share values).[10]

The court sided with IRS, a position for which there is ample authority.[11] Thus, the gifts were not eligible for the annual exclusion which resulted in a larger amount of adjusted taxable gifts and greater use of the unified credit in the process.

The estate also argued that the amount of the gift was the increase in stock value for the donees.[12] However, the court pointed out that the regulations state that the amount of gifts is measured by the value of property passing from the donor.[13] Thus, the gift was the $147,000 forgiveness of indebtedness.

Income tax consequence of forgiveness

Although *Estate of Stinson v. United States*[14] did not raise the question, probably because the statute of limitations had run on the resulting income tax liability, it has been the law since 1980[15] that cancellation or forgiveness of an installment obligation is treated as a disposition of the obligation.[16] If the obligor and obligee are related

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parties, as was the case in *Estate of Stinson v. United States*,[17] the amount taken into account as a disposition triggering recognition of unreported gain attributable to the obligation is not less than theface amount of the installment obligation.[18]

Thus, depending upon the income tax basis of the farmland sold to the corporation in *Stinson*,[19] there could have been a substantial amount of gain from the forgiveness of the $147,000 principal amount.

Other gift tax concerns

Another possible challenge in *Stinson*[20] which would likely have arisen had the forgiveness continued until sale of the property in 1990, is that consistent and regular forgiveness of obligations to pay can result in the forgiveness being considered a gift rather than a sale as of the date of the transaction.[21] That would have meant that the entire forgiveness would have been a gift in 1981 with the donees not receiving a new income tax basis derived from the purchase price but rather would have had a carryover basis from the donor.[22]

In conclusion…

The holding in *Estate of Stinson v. United States*[23] that the gift was a gift of a future interest to shareholders increased the amount of adjusted taxable gifts and boosted the federal estate tax liability. However, the outcome could have been even more disadvantageous to the estate and the heirs had the other two issues been raised successfully by the Internal Revenue Service.

Quite clearly, any gift should be handled with care; a gift of installment payments to a corporate purchaser deserves even more careful handling in light of the possible consequences to the seller (and the seller's estate) and the donees.

FOOTNOTES

1 I.R.C. § 1014(a).
2 See 6 Harl, *Agricultural Law* Ch. 46 (2000).
3 Estate of Stinson, 214 F.3d 846 (7th Cir. 2000).
4 214 F.3d 846 (7th Cir. 2000).
5 *Id*.
6 *Id*.
7 I.R.C. § 2503(b). See 6 Harl, supra note 2, § 46.04[1][a].
8 I.R.C. § 2503(b).
9 Treas. Reg. § 25.2503-3.
10 Estate of Stinson, 214 F.3d 846 (7th Cir. 2000).
11 Rev. Rul. 71-443, 1971-2 C.B. 337; Ltr. Rul. 7935115, May 31, 1979 (transfer of corporate stock to issuing corporation); Ltr. Rul. 8422015, Feb. 15, 1984 (same). See Heringer v. Commissioner, 235 F.2d 149 (9th Cir. 1956) (transfer of stock to family corporation; gifts were future interests although court did not face issue of whether gift was to corporation or gift to shareholders); Chanin v. United States, 393 F.2d 972 (Ct. Cl. 1968); Georgia Ketteman Trust v. Comm'r, 86 T.C. 91 (1986) (gift of future interest; argument rejected that donees comprised entire membership of board of directors and could have declared corporate dividend).
12 Estate of Stinson, 214 F.3d 846 (7th Cir. 2000).
13 Treas. Reg. § 25.2511-2(a).
14 See note 12, *supra*.
15 See Installment Sales Revision Act of 1980, Pub. L. No. 96-471, Sec. 2, 94 Stat. 2247, 2253 (1980), enacting I.R.C. § 453B(f).
16 I.R.C. § 453B(f)(1). See Rev. Rul. 86-72, 1986-1 C.B. 253 (decedent's estate recognized gain deferred under installment obligation election when obligations extinguished at decedent's death).
17 See note 12 *supra*.
18 I.R.C. § 453B(f)(2).
19 See note 12 *supra*.
20 See note 12 *supra*.
21 See Deal v. Comm'r, 29 T.C. 730 (1958). See Rev. Rul. 77-299, 1977-2 C.B. 343.
22 See generally 6 Harl, *supra* note 2, § 46.09[2].
23 214 F.3d 846 (7th Cir. 2000).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

ESTATE PROPERTY. The debtor was a watermelon and squash farmer who had suffered crop losses in 1998 and filed for Chapter 7 in February 1999. The debtor filed an application for disaster payments under the Crop Loss Disaster Assistance Program in April 1999 and a disaster payment was sent to the trustee. The debtor sought the recovery of the disaster payment from the trustee as not part of the bankruptcy estate because the debtor was not entitled to the payment as of the petition date. The court held that the disaster payment was estate property because all of the qualifying requirements, planting the crops and the disaster losses, occurred prior to the bankruptcy case petition. In addition, the court held that the disaster payments were the proceeds of the crops and included in the estate property. ***In re* Boyett, 250 B.R. 817 (Bankr. S.D. Ga. 2000)**.

EXEMPTIONS

DISASTER PAYMENTS. The debtor was a watermelon and squash farmer who had suffered crop losses in 1998 and filed for Chapter 7 in February 1999. The debtor filed an application for disaster payments under the Crop Loss Disaster Assistance Program in April 1999 and a disaster payment was sent to the trustee. The debtor sought to exempt the payment under Ga. Stat. § 44-13-100 as public assistance. The court held that the exemption was limited to "local public assistance" which did not include federal farm disaster