S Corporation Corner

By Stuart J. Frentz

Can an S Corporation Shareholder Make Nontaxable Gifts of S Corporation Stock to Service Providers?—A Holiday Recitation

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During the holiday season, an S corporation owner's fancy may turn to thoughts of gift giving, especially this year. Shareholders who want to make personal gifts of their stock may face several difficult tax issues.[1] This column will examine some of the more common concerns that arise when the recipient has a business relationship with the giver. With apologies to Charles Dickens, we turn to the illustrative case of Eben S.

Eben is the sole shareholder of S&M, Inc. (*i.e.*, Scrooge and Marley), a well-established and consistently profitable S corporation. Eben became the sole shareholder of S&M, Inc. when Jacob M., his longtime partner and mentor, died years ago and Eben purchased the stock from Jacob's estate. Now Eben is planning for his own eventual exit from the business. Before year-end, Eben is contemplating gifts of S&M, Inc. stock to three individuals: Bob, a key employee of S&M, Inc.; Jake, Jacob's son and namesake who also happens to be the corporation's outside accountant; and Frieda, Eben's niece who has never been involved in the corporation's business. Eben is not married and Frieda is his closest living relative. For tax advice, Eben consults Fezziwig, his personal attorney and business counsel to both Eben and S&M, Inc.

"I'd like to give away half my stock now and keep the other half," Eben explains. "Then I would leave the remaining stock under my will to the same three beneficiaries. I would prefer that no one has to pay taxes, but I expect you will tell me that isn't possible." Eben's top priority is that none of the recipients pay income taxes on his gifts. "I'm just in a holiday mood and these gifts are purely personal. I want to give exactly the same amount of stock to each."

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Fezziwig begins by recounting the tax rules that Eben and his transferees must consider. "First and foremost, there is Code Sec. 102(a), which provides that 'gross income does not include the value of property acquired by gift, bequest, devise or inheritance.'" (This sounds good to Eben.) "Unfortunately," Fezziwig goes on to point out, "Code Sec. 102(c)(1), added to the Internal Revenue Code in 1986, says the exclusion does not apply to 'any amount transferred by or for an employer to, or for the benefit of, an employee.' This statute will make it difficult for you to make a tax-free gift to Bob, and it may affect Jake's gift as well."

"The legislative history of Code Sec. 102(c)(1) indicates that a gift made by an employer to an employee *can* qualify for the Code Sec. 102 exclusion, but only in limited circumstances,"[2] the attorney explains. "The transfer must be made *exclusively* for personal reasons (such as a birthday or wedding present), must be *entirely unrelated* to the employment relationship and must reflect no anticipation of business benefit."[3]

Code Sec. 102(c)(1), added to the Internal Revenue Code in 1986, says the exclusion does not apply to "any amount transferred by or for an employer to, or for the benefit of, an employee.

Eben is unfazed. "The gifts I propose to make to Bob and Jake should meet those standards."

Fezziwig warns Eben that there are more hurdles. "The exception for 'pure' gifts was narrowed further (some might say closed completely) by Proposed Reg. §1.102-1(f)(2), a regulation first proposed in 1989 but never finalized." He reads the regulation to Eben:

> For purposes of section 102(c), extraordinary transfers to the natural objects of an employer's bounty will not be considered transfers to, or for the benefit of, an employee if the employee can show that the transfer was not made in recognition of the employee's employment. Accordingly, section 102(c) shall not apply to amounts transferred between related parties (e.g., father and son) if the purpose of the transfer can be substantially attributed to the familial relationship of the parties and not to the circumstances of their employment.

"So you see, this regulation says only members of the employer's family or who are 'the natural objects of the employer's bounty' are eligible for the exception to Code Sec. 102(c)(1), and even then only in rare situations."

"The good news is that this regulation is only proposed, and proposed regulations are not binding; they carry no more authority than positions advanced on brief by the IRS.[4] The bad news is that the regulation *does* represent the government's position and it is proposed to be effective for transfers made after December 31, *1986*. In the future, the proposed regulation could be made final and effective retroactively to that date." Fezziwig urges Eben to think hard about putting Bob in a position at risk under the proposed regulation. "It is one thing for *you* to treat your transfer to Bob as a gift by, say, reporting it on a gift tax return. It would be wholly another thing for Bob to exclude the value of the stock from his income based on your representation that it is a gift. Your friend and key employee could find himself caught up in an expensive dispute with the IRS down the road—one he could well lose."

Eben wonders whether the fact that he himself is not Bob's employer is of any consequence, but Fezziwig is not encouraging. "You are the sole shareholder of S&M, Inc., so it wouldn't be difficult for the IRS to make a case that any transfer you make to Bob may be considered to be 'for' S&M, Inc., which *is* his employer. You can't deny that Bob's ownership of S&M, Inc. stock would create a potential benefit for the corporation by increasing Bob's incentive as an owner to make the business a success," Fezziwig points out. "This line of reasoning has long been used to support special tax treatment for grants of incentive stock options and restricted stock to key employees of corporations."[5] Indeed, the income tax regulations provide that "a transfer of property by a stockholder to an employee of the corporation shall be treated as a contribution to the capital of the corporation by the shareholder, and a corresponding issuance of the property by the corporation to the employee as compensation."[6] If the stock transfer were determined to be "in connection with the performance of services" under Code Sec. 83 (a term broadly applied),[7] this rule would reroute Eben's gift to Bob through the corporation and therefore treated as a deemed transfer to Bob by his employer.

Eben is sorely tempted to mutter "Bah! Humbug!" (a traditional family expression), but restrains himself and shifts his focus to Jake. Jake is not an S&M, Inc.

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employee; Eben knows this because the corporation has always reported Jake's contract payments on Form 1099-MISC, not on Form W-2. "What do the Code and regulations have to say about gifts to service-providers who aren't employees?" he asks.

Fezziwig has found nothing in the Code, legislative history, regulations or rulings under Code Sec. 102(c)(1) to indicate that payments to independent contractors are subject to the same "*per se* not a gift" rule that applies to most employer-employee transfers. "However, this isn't the end of the analysis. This issue is also governed by judicial decisions and administrative rulings stretching back to *A.G. Bogardus*[8] and *M. Duberstein*,[9] the latter being an old chestnut of a case studied by generations of law students. In *M. Duberstein,* the U.S. Supreme Court considered whether and under what circumstances business gifts should be included in the income of two taxpayers, one a nonemployee and the other an employee.[10] Although it preceded the enactment of Code Sec. 102(c)(1) by 26 years, *M. Duberstein* is still cited in cases involving employer–employee payments and remains in play for transactions that aren't covered by that statute." [11]

Fezziwig summarizes the facts in *M. Duberstein*: One company's president gave the president of another company a new Cadillac as a "gift" in recognition of some promising sales leads that the latter had passed on—as he later testified—in the spirit of fellowship. Outside of his personal acquaintance with its president and a background of routine transactions between the two companies, the recipient had no relationship—as an employee, independent contractor or otherwise—with the company that gave him the car, and he did not include it as income on his tax return. The IRS challenged that treatment, and in the litigation that ensued evidence was presented that the gift was a personal gesture of goodwill and fellowship. The giver stated that neither he nor his company expected anything specific in return for the gift. Then again, the company treated the gift as a finder's fee on its income tax return and claimed a deduction for the cost of the car.

"The Supreme Court held that there are no bright-line rules for distinguishing gifts from compensation," Fezziwig told Eben. While gifts are made by reason of "detached and disinterested generosity … [and] out of affection, respect, admiration, charity or like impulses," the Court ruled, "the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift." A voluntary transfer of property to another for no consideration is not necessarily a gift that may be excluded from the recipient's income. Regardless of the lack of consideration, if a payment proceeds primarily from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature, it may not be excluded from income as a gift.[12]

The most critical factor is the transferor's intention in making the payment or transfer. However, the transferor's own characterization as to its purpose is not determinative. "[T]here must be an objective inquiry as to whether what is called a gift amounts to it in reality." According to the Court, the parties' expectations or hopes as to the tax treatment of the payment "have nothing to do with the matter."[13] The fact that the company that bought and transferred the car claimed an income tax deduction for paying a "finder's fee" seemed to tip the scales in favor of finding that the transferor's intention was to compensate Mr. Duberstein for providing valuable business information.

Fezziwig quotes the Court's well-known formulation of the rule which still applies today:

> Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case … [and] … primary weight in this area must be given to the conclusions of the trier of fact.[14]

He explains this somewhat flowery language means a high degree of deference will be given to the findings of the trial court and its readings of demeanor testimony in gift-or-compensation cases.[15]

Cases decided in the wake of *M. Duberstein* typically find that in business contexts, companies do not make transfers to nonemployee service providers out of "disinterested generosity."[16] A rare exception is *W.S. Spitz*,[17] which Fezziwig finds to have facts fairly close to Eben's situation *vis-à-vis* Jake. The IRS asserted a civil fraud penalty against an accountant and his spouse for omitting several items from income on their federal income tax returns. The alleged omissions included four $5,000 payments from a corporation for which Spitz had performed accounting work during the years at issue. Spitz was in charge of the corporation's account with his firm; he either performed or oversaw all of the corporation's accounting work and also advised the owners regarding their personal finances.

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Spitz and his wife established that they had known the Katz brothers—the principal shareholders of the corporation—for two decades and that the four had become close personal friends. The brothers were the only nonfamily members who attended such events as the Spitz's son's confirmation and bar mitzvah and their daughter's bat mitzvah and wedding. Ben Katz, who was not married, made regular trips across the state to watch the Spitz's son play high school basketball. When Gene Katz' wife traveled to Madison for medical care, she often stayed in the Spitz's home. Spitz was named as executor of Gene Katz's will. In sum, the Spitzes presented strong evidence that they and their family members had a close and long-standing personal relationship with the corporation's owners.

The Spitzes received four checks from the Katz Company—two in 1977 and another pair of checks in 1978—each for $5,000. Each check came with a note from Ben Katz expressing his and Gene's appreciation and friendship. Spitz's wife, Barbara, wrote thank you notes to the Katzes. The brothers further established that they and their company had a history of making generous gifts to individuals and institutions. In 1982, their company made an interest-free loan of $200,000 to Spitz's accounting firm which, according to testimony given during the trial, was made "solely because of the close personal relationship between Gene and Ben Katz and [Spitz]."[18]

> [I]f a payment proceeds primarily from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature, it may not be excluded from income as a gift.

Several items fell on the negative side of the ledger in the taxpayers' case. The checks were issued by the corporation, not by the Katz brothers individually, and all were written on a business account to which corporate payments for accounting and other professional services were posted. Neither the company nor the brothers filed federal or state gift tax returns with respect to the payments. In a move reminiscent of *M. Duberstein*, the Katz Company deducted the payments as corporate business expenses for financial accounting purposes and on its federal income tax returns for both years. When the Katz Company was audited by the IRS for 1979, however, the Katzes insisted they had always intended the payments as gifts. The brothers offered to concede the payments' nondeductibility but the IRS closed out the company's audit without commenting on that point.

The Tax Court decided *W.S. Spitz* primarily on the basis of the Katz brothers' forceful testimony that they intended the company's checks as gifts to the Spitzes. The court said that the testimony regarding the long, close friendship between the Spitz family and the brothers was "believable, entirely consistent, and credible."[19] The government did not file an appeal, likely due in no small part to *M. Duberstein*'s rule of deference to the trial court's findings in such cases.

"So," Fezziwig asks Eben, "what might a trier of fact discover in Jake's case? How long have you and Jake known each other? Have you ever vacationed or gone on trips with Jake's family? Have you made substantial personal gifts to Jake and his wife or children before? Do you have a history of giving Jake holiday presents, wedding or other special event gifts—perhaps before he became the company's accountant, or when he was a child? Are you the trustee of any trusts for Jake's benefit that Jacob or Jacob's wife may have set up? Before he died, did Jacob ask you to look out for young Jake? Are there any other facts and circumstances showing that your personal relationship with Jake is stronger than your business relationship?"

Eben considers these questions, and thinks his connection with Jake will stand comparison with the relationship between the Spitzes and the Katz brothers. "But," Eben protests, "my friendship with Bob's family runs even deeper and has a longer history. Bob is like a son to me." Not having children or a family of his own, Eben *has* participated in many get-togethers and special events with Bob's family—so much so the younger children call him "Uncle Eben." "Why can't the reasoning of the *W.S. Spitz* case apply here?"

Fezziwig is sympathetic, but continues to urge caution. "It is true that in the years before 1986, case law often did support the treatment of special payments by employers to employees as gifts, but all that changed with the enactment of Code Sec. 102(c)(1)." In *A.G. Bogardus*[20] the U.S. Supreme Court held that amounts paid in 1931 as a "gift or honorarium" by the Unopco Corporation to several former and present employees in recognition of their valuable and loyal services to the company were nontaxable gifts under the version of Code Sec. 102(a) then in effect. The

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Court was untroubled by the Unopco board's use of words that usually connote compensation:

> Some stress is laid on the recital to the effect that the bounty is bestowed in recognition of past loyal services. But this recital amounts to nothing more than the acknowledgement of an historic fact as a reason for making the gifts. A gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient.[21]

"As I've explained, Code Sec. 102(c)(1) displaced the prior rulings in this area as they applied to employees,"[22] Fezziwig says. "That section was added in concert with Code Sec. 74(c), which allows the exclusion of certain employee achievement awards. Congress apparently intended achievement awards to be the *sole* means of obtaining exclusion for payments in appreciation of employee services."[23]

Post-1986 case law follows the statute and proposed regulations regarding employee gifts.[24] In *H.P. Jinwright*,[25] a criminal tax evasion case, the Fourth Circuit Court of Appeals approved a jury instruction stating that "as a matter of law, payments from an employer to an employee do not qualify as nontaxable gifts, irrespective of the employer's intent." Now *H.P. Jinwright* is the latest of several "love offering" cases that involved "gifts" made to religious leaders by their congregations,[26] but it is not so much about whether the transfers could be treated as gifts under Code Sec. 102(a) as it is about whether the pastor was guilty of willful tax evasion under Code Sec. 6663(a). Its strong language nonetheless dramatizes how much the law has changed since *A.G. Bogardus*.

Fezziwig asks Eben to focus on the difference that Jake's status as an independent contractor makes. "The fact that Jake isn't an employee should take his case out from under Code Sec. 102(c)(1), opening the door for you to substantiate a personal, nonbusiness link as the primary inspiration for your gift of stock. Bob's status as an employee of your company places him in an entirely different category. The statute and its legislative history, along with the proposed regulation and post-1986 case law, should make you wary of trying to take the same route with an employee of your company, no matter how close your friendship may be."

"Now let's talk about Frieda for a moment. There are several ways you can transfer stock. You could make an outright gift, or you could transfer stock to a trust for Frieda's benefit. In either case, the gift would be subject to gift tax. Making an additional taxable gift before the end of this year will fit right in with the planning we've been doing to take advantage of your $5,120,000 lifetime exclusion.[27] You could 'leverage' your gift to Frieda by using a grantor trust structured so as to be an eligible S corporation shareholder.[28] As grantor, you would be treated as the owner of the S&M, Inc. stock for income tax purposes, while the trust for Frieda's benefit would be treated as the owner for gift and estate tax purposes; your payment of income taxes on the trust's share of the S corporation's income would be the equivalent of tax-free gifts to Frieda in the amount of the income tax liability each year."[29]

Fezziwig's observations about grantor trusts jog Eben's memory of previous discussions. "A few years ago didn't you tell me about another kind of transaction I could do with S corporation stock and a grantor trust?"

"Ah, you must be thinking of the time we talked about *selling* stock to an intentionally defective grantor trust, or IDGT," Fezziwig says. "That's a good technique for reducing gift and estate taxes while at the same time avoiding income taxes, but in this case you *want* to make currently taxable gifts so as to use as much as possible of your $5,120,000 exemption before the end of 2012. It wouldn't make a lot of sense to *sell* stock to an IDGT for Frieda right now[30]; *giving* (or as we say, "gifting") it to a grantor trust will make use of your exemption amount while still giving you the leverage of paying income taxes on income that will ultimately be Frieda's."

"But what about Bob or Jake?" Eben persists. "Could I achieve the results I want for them by selling stock to grantor trusts? Does the IDGT sale idea work for an employee or an independent contractor as it would for a family member?"

"Whoa," says Fezziwig, "not so fast. I have seen instances of IDGTs being used for employees, but I am not at all comfortable that the concept works in that context. An IDGT might work for Bob or Jake the same way it would in a gift and estate tax planning context—but only up to the final, crucial step. When grantor trust status terminates upon the grantor's death (or earlier if he renounces his grantor trust powers), I believe equivalent treatment would end."

"Remember that the key to IDGTs is the mismatch between federal income rules and federal estate and gift tax rules as they apply to grantor trusts. For income tax purposes, a transaction between an individual and a trust of which he is the grantor is

disregarded; it is as if the transaction occurred between the grantor and himself.[31] As long as the trust is irrevocable and the grantor retains no beneficial interest or power over the trust income or corpus that would cause a transfer to constitute an incomplete gift for federal tax purposes or that would cause the trust corpus to be included in the grantor's gross estate at death,[32] the transfer should be respected for federal gift and estate tax purposes."

Fezziwig asks Eben to imagine that he has set up an IDGT for Bob's benefit and has sold stock to the trust. "At some point in the future, grantor trust status will cease, either when you renounce the powers that make the trust a grantor trust or when you die. The moment *before* grantor trust status terminates, *you* would be treated as the owner of the S&M, Inc. stock in the IDGT for income tax purposes. The moment *after* grantor trust status terminates, the trust—a separate taxpayer—would be treated as owning that stock. That shift in ownership means you transferred the stock to the trust at the moment of termination. Because Bob would be the sole beneficiary of the trust, and Bob had been, and presumably would still be at that point a key employee of S&M, Inc., Code Sec. 102(c)(1), your nemesis, would come into play. Because it provides that 'Subsection (a) shall not exclude from gross income any amount transferred by or for an employer to, *or for the benefit of*, *an employee*' [emphasis added], the deemed transfer could not be treated as a gift or even, most likely, as a bequest."

For income tax purposes, a transaction between an individual and a trust of which he is the grantor is disregarded; it is as if the transaction occurred between the grantor and himself.

"An IDGT can work for a family member like Frieda because the implied shift in stock ownership that takes place upon termination of grantor trust status should be a gratuitous transfer for income tax purposes. In Frieda's case, that deemed transfer couldn't be a taxable gift or includible in your taxable estate; for those tax regimes, the transfer would have taken place much earlier when you sold the stock to the IDGT. The gratuitous nature of the deemed transfer upon termination of a trust for and employee, such as Bob, would not, however, protect against Code Sec. 102(c)(1), nor would it avoid the case law applicable to gratuitous transfers to service providers."

As the Supreme Court said in *M. Duberstein*,

> This Court has indicated that a voluntarily executed transfer of property by one to another, without any consideration or compensation therefor, though a common-law gift, is not necessarily a "gift" within the meaning of the [income tax] statute. For the Court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift.[33]

Fezziwig believes the termination of grantor trust status at Eben's death would result in a gratuitous transfer by Eben to a newly recognized trust for the benefit of Bob, an employee of S&M, Inc., with the transfer having the effect of benefitting S&M, Inc. by giving Bob additional incentive to perform as an employee. Eben's use of an IDGT to transfer stock to Bob might put off the day of reckoning under Code Sec. 102(c)(1), but has little chance of avoiding it altogether.

Eben makes a final stab at getting Fezziwig to say he can gift stock to Bob. "How would Code Sec. 102(c)(1) come into play if I set up an IDGT for Bob, never renounce my grantor trust powers, and Bob isn't a company employee when I die?"

Fezziwig parries Eben's thrust by pointing out that the same statutory phrase he cited earlier, when Eben protested that he wasn't Bob's employer, should apply. "The term 'by or for an employer' is broad enough to reach a shareholder's transfer of stock to an employee—especially if that transfer benefits the employer—even if the transfer is testamentary. If you set up an IDGT for Bob in that fashion, the conveyance that is due to occur at your death will be locked in when you sell stock to the trust—*i.e.*, when Bob *is* an employee. Remember, too, that Code Sec. 102(c)(1) 'turns off' the application of Code Sec. 102(a), which itself applies to 'property acquired by gift, *bequest, devise or inheritance*.'" [Emphasis added]

"As a practical matter, Code Sec. 102(c)(1) may allow some latitude for a straightforward bequest to Bob under your will if his employment S&M, Inc. has ceased before your death and if you have not made any promises that would link the bequest to his prior employment. I have found no reported cases in which the IRS attempted to deny tax-free treatment of a bequest to a personal adviser or domestic employee

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in appreciation of services rendered, unless the gift was made conditional on performance."[34]

"Let me sum up our discussion. First, with respect to Frieda, you can give her stock directly or you can transfer the stock to a trust for her benefit."

"As for Jake, the outlook for a nontaxable gift largely depends on whether you can substantiate that the transfer truly is prompted by feelings of friendship and affection and not by business considerations. I will help evaluate the evidence of your personal relationship."

"Due to Code Sec. 102(c)(1), discretion is the better part of valor when it comes to Bob."

Reluctantly, Eben agrees. "I will not lead Bob to think he can exclude the value of any stock I may give him this year from his income, but I will consider whether the company should pay Bob an additional bonus to make up for all or part of the difference that income taxes will take from his net. I will ask Jake to run some numbers and then confer with you again as to the feasibility of this plan. I am also planning to leave Bob some stock under my will. If he must treat the bequest as income because he continues to be employed at my death—which, by the way, I certainly hope will be the case for the good of the company—so be it."

"Today I seem to have been visited by three spirits, Fezziwig, all in your person," Eben muses. "The spirit of *M. Duberstein* and the other cases was interesting as well as edifying, but the spirit of that certain Code section—which I shall not name—chilled me to the core. Finally, thoughts of holiday gift-giving and good times spent with family and friends have lifted my spirits, and I am thankful for the advice and counsel you have given."

[Exeunt. Here let us draw the curtain on our Dickensian pastiche.]

ENDNOTES

1 *See* James A. Nitsche, *Intrafamily Transfers of Interests in the Family Business: Gift, Compensation or Both?* TAXES, Oct. 1, 2008, and Jay A. Soled, *Taxation of Business Gifts*, TAXES, May 1, 2001.

2 S. REPT. 99-313, at 49 (1986), 1986-3 CB (Vol. 3) 1, 49.

3 *Id. See also E.B. Caglia*, 57 TCM 1, Dec. 45,585(M), TC Memo. 1989-143 (Only where the relationship between employer and employee is personal and payment is made for reasons unrelated to the work relationship may it be treated as a gift).

4 *F.W. Woolworth Co.*, 54 TC 1233, Dec. 30,169 (1970); *Estate of R.D. Howard*, 91 TC 329, Dec. 45,002 (1988).

5 *See, e.g.*, Code Secs. 83, 421, 422 and 423 and the regulations thereunder.

6 Reg. §1.83-6(d).

7 Reg. §1.83-3(f); *see also Montelepre Systemed Inc.*, 61 TCM 1782, Dec. 47,154, TC Memo. 1991-46, *aff'd on another issue* CA-5, 92-1 USTC ¶50,196, 69 AFTR 2d 92-958 (it is not necessary for service provider to receive property as compensation for Code Sec. 83 to apply; all that is required is some sort of relationship between services performed and property transferred).

8 *A.G. Bogardus*, CA-2, 37-1 USTC ¶9166, 302 US 34, 19 AFTR 1195, (1937).

9 *M. Duberstein*, SCt, 60-2 USTC ¶9515, 363 US 278 (1960).

10 The decision resolved two different cases; *M. Duberstein* was a nonemployee case while the other, *Stanton*, involved an employee.

11 *H.P. Jinwright*, CA-4, 2012-2 USTC ¶50,417, 109 AFTR 2d 2012-2729, 683 F3d 471 (discussed *infra*); *L.K. Springer*, CA-10, 2007-1 USTC ¶50,520, 108 AFTR 2d 2011-6926, 444 Fed. Appx 263 (the question whether a particular transfer is a "gift" depends on the facts of the case, turning primarily on the transferor's intent); *L.L. Goodwin*, CA-8, 95-2 USTC ¶50,534, 67 F3d 149 (donations of cash from a congregation to a pastor includible in taxable income when congregation leaders gathered donations in a routine, highly structured program and amounts were substantial compared to the pastor's salary); *F.J. Larsen*, 95 TCM 1273, Dec. 57,378(M), TC Memo. 2008-73 (taxpayer who failed to establish that a payment of $160,000 received from her employer stemmed from a personal relationship had to include the amount in taxable income as bonus and could not exclude it as a gift); *L.B. Williams*, 85 TCM 1113, Dec. 55,105(M), TC Memo. 2003-97 (performance-related bonuses received by wife as key employee not excludible gifts; taxes and penalties imposed); *A.M. Owens*, TC Summ. Op. 2004-102 (Jul. 28, 2004) (executive assistant failed to show $7,500 payment received from supervisor and reported on Form 1099-MISC was a personal gift).

12 *Supra* note 9.

13 *Id.*

14 *Id.*

15 Accordingly, the Supreme Court deferred to the trial court in both cases before it. In *Duberstein*, it reinstated the Tax Court's finding that *Duberstein* had to include the value of the automobile in his income as compensation, the Sixth Circuit had reversed. In *Stanton*, it vacated the judgment of the Second Circuit and remanded to the District Court which originally held that a $20,000 payment made by Trinity Church to its comptroller and president of its real estate management subsidiary upon his departure was a gift.

16 *See, e.g., T.F. Payson*, 25 TCM 1099, Dec. 28,119, TC Memo. 1966-212 (4,000 shares of stock in a mining company held to be compensation rather than a gift where recipient had been engaged to help negotiate sale of the company's iron ore); *R.W. Hodge*, 32 TCM 277, Dec. 31,898(M), TC Memo. 1973-64 (one-time bonus payment to distributor based on number of planes sold constituted taxable income rather than a nontaxable gift despite payor not having claimed a deduction for the payments).

17 *W.S. Spitz*, 60 TCM 920, Dec. 46,903(M), TC Memo. 1990-519. *See also R.L. Harrington*, 17 TCM 277, Dec. 23,252(M), TC Memo. 1958-194 decided under the 1939 Code ($10,000 payment by partnership to employee and his wife to enable them to enlarge their home held a gift, not compensation, on showing of a long personal friendship of the couple and the two partners, the partnership claimed no deduction for the payment, and the partners' stated intention was to make a gift just large enough to cover the costs of work needed on recipients' home; because the recipient was an employee of the partnership, Code Sec. 102(c)(2) presumably would produce a different result today).

18 *Id.*

19 *Id.*

20 *Supra* note 9.

21 *Id.* at 1199; *E.B. Caglia*, *supra* note 4 (payments received by taxpayer from her

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employer whom she accompanied on gambling trips not taxable). *See also* Rev. Rul. 81-186, 1981-2 CB 85 (transfers of stock by A, corporation's sole shareholder, to three corporate officers/employees were nontaxable gifts where one recipient was A's brother-in-law and the other two were unrelated. It was stipulated without discussion that A's transfers to B, C and D were subject to gift tax and did not result in any amount being included in the recipients' income "since the transfers were motivated solely by A's donative intent and were not in consideration of either past or future services").

[22] T.D. 8831, which accompanied the issuance of regulations on the application of grantor trust rules to certain trusts established by foreign persons. Reacting to comments that the proposed regulations overturned prior case law, Treasury said that "[t]he result in *Bogardus* might well be different today under section 102(c)(1) (enacted in 1986), which provides that the exclusion from gross income for the value of property acquired by gift does not apply to any amount transferred by or for an employer to, or for the benefit of, an employee." The T.D. also distinguishes *Bogardus* on the basis that the payor was a domestic corporation and did not treat the payment as a deductible expense.

[23] *See* House Conf. Rpt. No. 99-841, Act Sec. 112(a) of the Tax Reform Act of 1986 (P.L. 99-514).

[24] *A.M. Owens*, TC Summ. Op. 2004-102 (Jul. 28, 2004) (only in "exceptional" circumstances should a transfer between an employer and an employee be considered a gift in the statutory sense); *L.B. Williams*, supra note 9 (if a gift is made solely for personal reasons such as a birthday or wedding present, is in no way related to an employment relationship and no anticipation of business benefit exists, then the gift may qualify for Code Sec. 102(a) exclusion).

[25] *H.P. Jinwright*, CA-4, 2012-2 USTC ¶50,417, 109 AFTR 2d 2012-2729, 683 F3d 471.

[26] Michael P. Mosher and Ryan K. Oberly, *A Gift Not so Simple – Current Tax Issues Associated with "Love Offerings"*, Taxation of Exempts, Jul.–Aug. 2012 (forthcoming).

[27] Code Sec. 2010(c)(3)(A). The gift tax exclusion is scheduled to return to $1 million effective January 1, 2013; for sunset provisions see Act Sec. 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) (EGTRRA), as amended by Act Sec. 302 of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, (P.L. 111-312).

[28] Code Sec. 1361(c)(2)(A)(i); Reg. §1.1361-1(h)(1)(i).

[29] Rev. Rul. 2004-64, 2006-2 CB 7; *see* David R. Nave, *GPS Navigation: Mapping the Use of Trusts in S Corporations*, J. Passthrough Entities, Jul.–Aug. 2008, at 35.

[30] A full discussion of the IDGT concept is beyond the scope of this column and we can only touch on a few high points. For further information and details, *see* Robert C. Walthall, *Spring Training for Tax and Estate Lawyers: Using Grantor Trusts to Own S Corporation Stock*, J. Passthrough Entities, Mar.–Apr. 2009, at 35; Robert Keebler, *Intentionally Defective Grantor Trust (IDGT) Sales*, Taxes, Dec. 17, 2007; Mark S. Poker, *Sales to Intentionally Defective Grantor Trusts*, Practical Tax Lawyer, Fall, 2010, at 15; Zaritsky, Tax Planning for Family Wealth Transfers: Analysis with Forms, ¶12.07 (WG&L, 4th ed. 2002 & Supp. Feb. 2011). Note that the Obama administration's FY2013 Budget includes a proposal to change the rules for grantor trusts in a way that would eliminate the gift and estate tax benefits currently thought to be available with IDGTs. The Treasury Department's "General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals" contains the following statement:

> Coordination of income and transfer tax rules applicable to grantor trusts.
>
> The current lack of coordination between the income and transfer tax rules applicable to a grantor trust creates opportunities to structure transactions between the deemed owner and the trust that can result in the transfer of significant wealth by the deemed owner without transfer tax consequences. New rules for grantor trusts would prevent this by: (1) including the assets of the trust in the grantors' gross estate of that grantor for estate tax purposes, (2) subjecting to gift tax any distribution from the trust to one or more beneficiaries during the grantor's life, and (3) subjecting to gift tax the remaining trust assets at any time during the grantor's life if the grantor ceases to be treated as an owner of the trust for income tax purposes. These rules would apply for trusts created on or after the enactment date and with regard to any portion of a pre-enactment trust attributable to a contribution made on or after the enactment date.

[31] Rev. Rul. 85-13, 1985-1 CB 184.

[32] *E.g.*, under Code Secs. 2036 and 2038.

[33] *M. Duberstein*, 363 US at 284.

[34] *See L.S. Jones*, 23 TCM 235, Dec. 26,658(M), TC Memo. 1964-39 (amount left to attorney-adviser was a bequest and not taxable to him); Rev. Rul. 57-398, 1957-2 CB 93 (because the legatee's right to receive an amount under decedent's will was not contingent upon the performance of services, the bequest was excludable from income under Code Sec. 102(a)); Rev. Rul. 67-375, 1967-2 CB 60 (property distributed under terms of a will pursuant to a written agreement requiring the recipient to perform services for testator was compensation for services); *V.R. Wolder*, 58 TC 974, Dec. 31,543 (1972) (bequest was compensation for services performed during decedent's lifetime pursuant to written agreement).

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