



Tax Notes Today

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Court Holds for Taxpayer in 40-Year-Old Case; No Gift Tax Owed

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Summary by **taxanalysts**

A 40-year-old tax dispute involving the Redstone family, known for their ownership in CBS Corp. and Viacom Inc., has come to its conclusion, with the Tax Court holding October 26 that the children did not receive a gift but rather a transfer of shares.

Full Text Published by **taxanalysts**

A 40-year-old tax dispute involving the Redstone family, known for their ownership in CBS Corp. and Viacom Inc., has come to its conclusion, with the Tax Court holding October 26 that the children did not receive a gift but rather a transfer of shares.

In *Estate of Edward S. Redstone v. Commissioner*, 145 T.C. No. 11 (2015) , the court said that in determining whether a transfer of property was made in the ordinary course of business -- causing an exception from the gift tax -- it matters only that the transferor of stock receive consideration for the transfer, not whether the transferees gave up consideration.

Mitchell Gans of Hofstra University School of Law said the court's decision appears to be the correct answer given the regulations in the area and the problematic nature of the IRS's argument that consideration must be received from the transferee in order to apply the ordinary course of business exception.

"Judge Lauber's decision is right on the merits," Bridget J. **Crawford** of Pace University Law School said. Edward Redstone did not make a gift to his children; he transferred shares to them to settle a lawsuit with his father, and "that is a bona fide, arm's-length transaction free of any donative intent if I've ever seen one," she said.

Howard J. Castleman of Castleman Law LLC, who represented Edward Redstone's estate, said he thought the Tax Court's opinion was well reasoned and that it supports -- both legally and factually -- what Edward Redstone had maintained his whole life: that his departure from the family business in 1972 and the transfer of his stock to trusts for his children were the result of a compromised settlement. "In the end, the Tax Court's opinion was a largely straightforward application of established gift tax law to a clear set of facts, no matter how extraordinary those facts were," Castleman said.

Background

"It's unusual to see a 1972 gift tax case, and what they were arguing about was something even older than that, dating back to a supposed oral trust from 1959," Ronald D. Aucutt of McGuireWoods LLP said.

The petitioner is the estate of Edward Redstone, who died in 2011. The dispute surrounds a settlement in 1972 between Edward and his father, Mickey, and brother, Sumner. Sumner Redstone is well known as the majority owner of CBS and Viacom.

From the 1930s to the 1950s, Mickey built a real estate and movie theater business, which was eventually consolidated into a single holding company, National Amusements Inc. (NAI). Mickey, Edward, and Sumner each received one-third of NAI's only class of stock. Upon NAI's incorporation, Mickey, Edward, and Sumner contributed \$30,328, \$17,845, and \$18,445, respectively.

Toward the end of the 1960s, disputes arose between Edward and his father and brother, leading Edward to feel marginalized within the business and family. His role at NAI gradually decreased, and Edward in 1971 quit the business and threatened to sell his shares of the company to an outsider. Mickey, who wanted to keep control of the business within the family, refused to hand over the stock certificates, claiming that Edward's shares were in trust for Edward's children.

Mickey claimed that in 1959, when he created NAI, the shares had been held in an oral trust created at the same time. After months of negotiations, the parties agreed to settle by giving one-third of Edward's shares to trusts in the benefit of his two children. His remaining shares were sold back to NAI for \$5 million.

Edward did not file a federal gift tax return in 1972.

Legal Issues

The IRS in 2013 issued a notice of deficiency for \$737,625 in federal gift tax for the 1972 tax year. Under [section 2501\(a\)\(1\)](#), gift tax is imposed on the transfer of property by gift.

[Section 2512\(b\)](#) says that when property is transferred for less than an adequate and full consideration, the amount by which the value of the property exceeded the value of the consideration must be a gift. [Reg. section 25.2511-1\(g\)\(1\)](#) says that the gift tax also doesn't apply to ordinary business transactions. A transfer of property in the ordinary course of business is "a transaction which is bona fide, at arm's length, and free from any donative intent." These three conditions are based on objective facts of the transfer rather than the subjective motives of the donor.

The court found that all three elements of a transfer of property in the ordinary course of business were met, therefore satisfying the exception from gift taxes.

"The focus of the parties' dispute is whether Edward's transfer of stock in trust for his children was made for 'an adequate and full consideration in money or money's worth,'" the court said.

After a lengthy discussion, the court noted that the IRS did not "seriously challenge" the estate over whether Edward provided consideration in the 1972 transaction. What the IRS challenged, however, is whether Edward's children provided consideration in exchange for the transfer of the shares.

"Respondent's argument derives no support from the text of the governing regulations," the court said, adding that it does not matter whether the transferees provided consideration, because the regulations ask whether the transferor received consideration.

The court decided that Edward received full and adequate consideration in the form of recognition by Mickey and Sumner that he was the outright owner of 66-2/3 shares and NAI's agreement to pay \$5 million in exchange for those shares.

Gans said he thinks the IRS's basic argument that Edward must have received the consideration from the third party, the children in this case, was inconsistent with the law. "I think what really happened here is that the real gift was made by the grandfather, Mickey," he said. "I think that at the end of the day, the IRS went after the wrong taxpayer."

"I think these third-party transactions are a little treacherous for the IRS because it comes down to the identity of the donor," Gans said. Clearly there was a gift, and by concluding it was not made by Edward, the court implicitly concluded it was made by Mickey, Gans said.

"I see more family disputes than I'd like to see, and a lot of times they are settled by moving assets around the family," Aucutt said. "I appreciate that while the IRS sees the moving of assets and is concerned with the avoidance of the gift tax, usually making gifts to one another is the last thing these folks have in mind while settling these kinds of disputes," he said.

Aucutt speculated that had the assets that were transferred to Edward's children lost their value, the IRS would not have gone after the transaction, and "from that perspective it is not as easy to be sympathetic with the IRS." He added, "Trying to go back and establish facts from 1959 and 1972 transactions just doesn't seem like a wise application of resources by the IRS."

Conflicting Arguments

In Rev. Rul. 77-314, 1977-2 C.B. 349, the IRS indicated that consideration does not need to be received from the transferee in order to count for purposes of the gift tax. "As a result, the amount of A's gift to the child of the income interest is the excess of the value of the income interest transferred to the child over the value of consideration received by A for that transfer," the revenue ruling says. That sentence is directly contrary to the argument the IRS made in the case, Gans said.

Gans also suggested that the children did provide consideration, which conflicts with the court's conclusion. Gans argues that, under the oral trust, the children had a claim to shares in the corporation. To the extent that they received fewer shares under the settlement than under the terms of the oral trust, they did in fact suffer a diminution in their rights that inured to the benefit of Edward.

Sumner Redstone Case

There is still an open Tax Court case for the same tax year involving Sumner Redstone as the petitioner, *Redstone v. Commissioner*, T.C. Dkt. No. 8097-13 (filed Apr. 10, 2013) . That case contemplates whether stock placed in trust for Sumner's children in 1972 as part of the settlement is a gift. (Prior coverage . Prior analysis .)

Crawford noted that in footnote 4 of the October 26 decision, the Tax Court makes clear that when no gift tax return is filed, the statute does not begin to run. "I expect that the Tax Court will reject any

statute of limitations argument by Sumner Redstone," she said.

In footnote 2, the court observed that Edward's and Sumner's cases are different in that Edward transferred shares to his children to settle a lawsuit that he brought. "Whether Sumner will be able to claim that his transfer to his own children was in settlement of that suit remains to be seen; I predict a finding of a taxable gift in that case," **Crawford** said.

Tax Analysts Information

Code Sections: Section 2501 -- Imposition of Gift Tax
Section 2511 -- Gift Tax
Section 2512 -- Valuation of Gifts

Jurisdiction: United States

Subject Areas: Gifts
Trusts and estates taxation
Litigation and appeals

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