

**Steve Leimberg's Estate Planning Email Newsletter - Archive Message #869****Date:** 07-Sep-05**From:** Steve Leimberg's Estate Planning Newsletter**Subject:** PLR 200534014 - Transfer from Legal to Beneficial Owner Not Tax Gift

Please welcome our latest LISI Commentator, **Jeff Baskies**, a shareholder in **Ruden, McCloskey's** Ft. Lauderdale office.

Jeff is a graduate of Trinity College (with highest honors), Harvard Law School (cum laude), and is Board Certified by The Florida Bar (emeritus) as a specialist in Wills, Trusts and Estates law.

His articles have been published in various legal periodicals including Estate Planning, Trusts and Estates, The Family Advocate, The Florida Bar Journal, LAN, and Probate and Property. Please welcome Jeff to the LISI Commentator Team!

Jeff shares a case that gets to the right result – but reminds us of a nagging – and still unanswered question dealing with the gift tax implications of one party guaranteeing another party's loans.

**EXECUTIVE SUMMARY:**

Where Father held legal title to shares of stock in Company and interests in Limited Partnership and Limited Liability Company, all of which were equitably owned by Son, Father's changing title to those assets to Son's name will not be a taxable gift under Code Section 2511.

**MORE FROM JEFF BASKIES ON PLR 200534014 TO FOLLOW. BUT FIRST, EDITOR ANDY DeMAIO ISSUES A LISI LAWTHREADS ALERT!**

**1. KPMG PARTNERS: VICTIMS OR VILLIANS?** In a lively and sometimes contentious discussion, practitioners react to KPMG's recent admission of tax fraud, its agreement to pay \$456 million in penalties, and the criminal indictment of several of its partners.

**2. PRESERVING FISCAL YEAR ELECTION FOR ESTATE**

When completing Form SS-4 to obtain a tax ID number for a new estate, the personal representative lists the ending month of the estate's fiscal year. But a recent online discussion reminds us the estate still has flexibility in choosing its tax year.

### **3.QUICK TAKE: 2005 FORM 706 AND 709 REVISIONS**

Estate tax returns for decedents who died in early January will be due in early October, about a month from now. But the IRS forms for those returns are still not available. This thread provides an update on the scheduled release of the new Forms 706 and 709, and shows you where to find a draft of the 2005 Form 706.

To read these and other recent LawThreads reviews, log in at <http://www.leimbergservices.com>. Once you've logged in, click the blue LawThreads button under Recent Entries.

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### **NOW BACK TO PLR 200534014!**

#### **FACTS:**

Son was the "driving force" behind organizing a new Company.

But at the time he was building the company, he was also experiencing personal credit difficulties.

As a result, Son provided funds to Father for Senior to purchase shares in son's Company and to hold them on behalf of Son.

His father agreed to take title to the shares on behalf of son.

Father became the majority shareholder of Company on paper, but was not involved in the business. The primary justification or reason offered for Father's taking title to the shares was so Company could benefit by the Father's creditworthiness. Father apparently agreed to execute personal guarantees which allowed Company to obtain necessary financing.

Subsequently, all of the Shareholders in the Company (including Father) received an interest in a Limited Partnership ("LP") and a Limited Liability Company ("LLC") (created to be general partner of the LP).

Again, Father took title to these interests on behalf of Son.

Father represented and stipulated that the shares of Company and the interests in LP and LLC were held by Father for the benefit of Son and he had no real equitable or beneficial interest in those assets. It was also stipulated that all of the founding shareholders were aware that Father held the shares in the Company and the interests in LP

and LLC for the benefit of his Son.

After some time, the creditworthiness of father was no longer needed, and he wanted to transfer the shares to son.

Father requested a ruling that, causing the stock register of the Company and the ownership registries of the LP and LLC to be changed to Son's name will not be a taxable gift under Code Section 2511.

## **COMMENT:**

### **REQUIREMENTS FOR GIFT TO BE TAXABLE:**

Subject to certain exclusions, deductions and credits, Code Section 2501(a)(1) imposes a gift tax on the gratuitous transfer by an individual of property via a lifetime gift in exchange for less than full and adequate consideration in money or money's worth.

Code Section 2511(a) provides that the gift tax applies to transfers by way of gift – whether outright or in trust, direct or indirect, etc. The legislative history of the gift tax shows it was intended to be broadly applied.

But to be taxable, there must be both a transfer of property and the transfer must be complete.

### **GIFT INCOMPLETE UNTIL DONOR PARTS WITH DOMINION AND CONTROL**

In the PLR, the Service noted that Treas. Reg. 25.2511-2(b) provides in part "that a gift of property is complete to the extent the donor has so parted with dominion and control as to leave him no power to change its disposition, whether for his own benefit or for the benefit of another." The Service also noted that: "a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself".

Similarly, in *Burnet v. Guggenheim*, the United States Supreme Court held that the Federal gift tax "is not aimed at every transfer of the legal title without consideration. Such a transfer there would be if the trustees were to hold for the use of the grantor. It is aimed at transfers of title that have the quality of a gift, and a gift is not consummate until put beyond recall." See also Rev. Rul. 54-537, where the right to revest the beneficial title to property transferred in trust by the donor is an incomplete gift, and Rev. Rul. 74-365, where the Service held a gift causa mortis was not a completed gift because the gift was revocable and the subsequent return of the property did not result in a gift."

## **A MERE SHIFT OF LEGAL TITLE TO BENEFICIAL OWNER NOT A GIFT**

In reliance upon the Code Sections and Regulations cited above, and the Supreme Court's holding in Guggenheim, the Service ruled that the proposed transfers of title to the shares of Company and the interests in the LP and LLC from Father to Son did not create a taxable gift as it was merely father's relinquishing legal title to the property to the rightful, equitable and beneficial owner.

Given the facts and the citations above, the ruling seems perfectly logical. Father held the interests as nominee for Son and should not incur a gift tax to transfer his "naked" legal title to Son (the beneficial owner). At that level, PLR 200534014 provides a friendly reminder that it is okay for a legal-title owner to release the property to the equitable or beneficial owner.

### **GIFT TAX CONSEQUENCES OF GUARANTEE OF DEBT:**

However, one interesting and important issue was NOT addressed in the PLR. That issue is the gift tax consequences of Father's guarantee of Company debt. If Son was equitable owner, that means Father guaranteed Son's debt – providing creditworthiness Son could not have achieved on his own. That allowed Company to be developed and assumedly had significant economic benefit (otherwise, again assumedly, Son would have taken title to the shares in Company himself).

Should the IRS' not addressing the issue at all in this case where it was so clearly presented be given meaning? Is it an indication that the IRS is no longer interested in pursuing the gift on guarantee argument?

Unfortunately, that issue is not answered by the PLR, and it would not be prudent to jump to any conclusions, because the gift on guarantee issue is ignored. But it makes one wonder how seriously the IRS is concerned about the gift by guarantee issue, which has been a cause for concern by numerous practitioners for years.

The Tax Court in *Bradford v. Commissioner*, held that a guarantee of payments for another person's debts did not constitute a completed gift because the guarantee may never be called upon.

### **IRS IN PAST HAS ARGUED GUARANTEE IS GIFT!**

However, the IRS has taken the opposite position. It has argued that guaranteeing the payment of someone else's debts IS a valuable property right. So the act of providing a guarantee of paying someone else's loan can constitute a taxable gift on the date the

guarantee becomes binding.

That position was espoused in PLR 9113009, the facts of which are very similar to this PLR. In PLR 9113009, a parent guaranteed a loan for the acquisition of business interests by his children. Relying upon *Dickman v. Commissioner*, the IRS ruled that the guarantee was a taxable gift on the date it became effective. Interestingly, PLR 9113009 was withdrawn by PLR 9409018. In that PLR, the IRS withdrew PLR 9113009, but without comment on the portion of PLR 9113009 which dealt with the taxable gift issue.

### **NOT IN RULING BECAUSE IT JUST DIDN'T COME UP!**

So we are left with the holding in PLR 200534014 that there was no gift when Father transferred the stock and interests in the LP and LLC to Son, but which was silent on the gift tax consequences, if any, of the Father's guaranteeing the Company debt on its formation.

I talked to **Mayer Samuels**, primary drafter of the PLR. He said that the issue of guarantee as gift was not addressed in the ruling because the issue was not brought up. He said the ruling can't/shouldn't be used for reading anything into the IRS' position on guarantees as gifts, was not really sure what the official position on the subject was, but said he thought that the IRS still might consider guarantees as taxable gifts in the right circumstances.

So where is the IRS going on guarantees of loans?

Stay tuned to LISI...

**HOPE THIS HELPS YOU HELP OTHERS!**

## **Jeff Baskies**

Edited by Steve Leimberg

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### **CITES:**

"(Treas. Reg.) Section 25.2511-2(c); *Burnet v. Guggenheim*, 288 U.S. 280 (1933); *Bradford v. Commissioner*, 34 T.C. 1059 (1960);

Dickman v. Commissioner, 465 U.S. 330 (1984); PLR 9113009 ;  
PLR 9409018 ; Rev. Rul. 54-537 , 1954-2 C.B. 316, Rev. Rul. 74-  
365 , 1974-2 C.B. 324 .