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CROWN v. COMMISSIONER: GIFT TAXATION AND INTEREST-FREE LOANS AMONG FAMILY MEMBERS

Congress enacted the gift tax¹ both to supplement the income and estate taxes and to preclude the avoidance of those taxes through a practice of inter vivos giving.² The code provisions of the current gift tax, which was established in 1932,³ broadly describe the kinds of property and types of transfers subject to gift taxation.⁴ Consistent with the sweeping scope intended by Congress,⁵ the judiciary has construed these provisions liberally in ascertaining the transactions subject to the gift tax.⁶

In the recent case of *Crown v. Commissioner*,⁷ however, the Tax Court held that interest-free loans to family members are not taxable gifts. Consequently, one may transfer significant amounts of money to family members without incurring gift tax obligations, despite contrary congressional and judicial determinations in analogous transactions. *Crown* thus sanctions an exception to the congressional system of comprehensive taxation in which the interrelated estate, gift, and income taxes⁸ are designed to tax the realization of income and the transfer of money or property.⁹ Furthermore, the decision

1. The principal provisions of the gift tax are set forth in I.R.C. §§ 2501-2524.

2. The gift tax will supplement both the estate tax and the income tax.

It will tend to reduce the incentive to make gifts in order that distribution of future income from the donated property may be to a number of persons with the result that the taxes imposed by the higher brackets of the income tax law are avoided. It will also tend to discourage transfers for the purpose of avoiding the estate tax.

H.R. REP. No. 708, 72d Cong., 1st Sess. 28 (1932); S. REP. No. 665, 72d Cong., 1st Sess. 40 (1932), reprinted in 1939-1 C.B. pt. 2, 457, 477. See *Smith v. Shaughnessy*, 318 U.S. 176, 179 n.1 (1943). See generally *Harriss, Legislative History of Federal Gift Taxation*, 18 TAXES 531, 533 (1940).

3. Gift Tax Act of 1932, ch. 209, §§ 501-532, 47 Stat. 245-59.

4. See, e.g., I.R.C. § 2511(a), which provides in part: "[T]he tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible"

5. See text accompanying note 10 *infra*.

6. See notes 20-28, 79-83 *infra* & accompanying text.

7. 67 T.C. 1060 (1977), appeal docketed, No. 77-1898 (7th Cir., Sept. 2, 1977).

8. See, e.g., *Smith v. Shaughnessy*, 318 U.S. 176, 179 (1943); C. LOWNDES & R. KRAMER, *FEDERAL ESTATE AND GIFT TAXES* 576-77 (2d ed. 1962).

9. See C. LOWNDES & R. KRAMER, *supra* note 8, at 576.

subverts the congressional intent to subject to gift taxation "all the protean arrangements which the wit of men can devise that are not business transactions within the meaning of ordinary speech."¹⁰

After briefly tracing the legislative and judicial history of the gift tax, this Comment will review the decisions involving both income and gift tax issues that shaped the analytical framework for the Tax Court's opinion in *Crown*. Thereafter, an examination of *Crown* itself will reveal the impropriety of the court's holding and provide the requisite understanding to forecast the effects of the decision.

GENERAL CONSTRUCTION OF THE GIFT TAX

Although the Internal Revenue Code does not define the term "gift,"¹¹ the Senate Committee Report¹² provides evidence of the breadth that Congress intended both for that particular word and for the provisions of the entire tax: "The words 'transfer . . . by gift' and 'whether . . . direct or indirect' . . . comprehend all transactions [in which] property or a property right is donatively passed to or conferred upon another, regardless of the means or device employed in its accomplishment."¹³ In this context the term "gift" does not incorporate its common law meaning¹⁴ because a taxable transfer need not embody a specific donative intent.¹⁵ Rather, Congress adopted an

10. *Commissioner v. Wemyss*, 324 U.S. 303, 306 (1945).

11. D. KAHN & E. COLSON, *FEDERAL TAXATION OF ESTATES, GIFTS, AND TRUSTS* 251 (2d ed. 1975); C. LOWNDES & R. KRAMER, *supra* note 8, at 574.

12. S. REP. NO. 665, 72d Cong., 1st Sess. 39 (1932), *reprinted in* 1939-1 C.B. pt. 2, 496, 524.

13. *Id.* Property has been construed judicially to include contingent and non-contingent rights and interests in property. *See, e.g., Robinette v. Helvering*, 318 U.S. 184 (1943) (contingent remainder interest); *Herzog v. Commissioner*, 116 F.2d 591 (2d Cir. 1941) (contingent life estate); *Lois J. Newman*, 19 T.C. 708 (1953), *aff'd on other grounds*, 222 F.2d 131 (9th Cir. 1955) (rights to an income tax refund); *Harold B. Adams*, 22 T.C.M. (P-H) 1996 (1953) (rights in patent applications). "Even though concepts of property and value may be slippery and elusive, they cannot escape taxation so long as they are used in the world of business." 5 J. MERTENS, *LAW OF FEDERAL GIFT AND ESTATE TAXATION* 39 (1959). *See also* C. LOWNDES & R. KRAMER, *supra* note 8, at 588-89.

14. The common law defines a gift as "a voluntary transfer of property by the owner to another without consideration or compensation. . . . A donative intent is necessary to constitute a valid gift." C. SMITH & R. BOYER, *SURVEY OF PROPERTY* 469 (2d ed. 1971).

15. Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

objective measurement, the "adequacy of the consideration" test, to identify a gift for tax purposes.¹⁶ Under this test, the amount of any transfer subject to gift taxation consists of the difference between the fair market value of the property or property right conveyed and the sum of the consideration received in exchange.¹⁷

Circumventing the requirement of establishing a subjective donative intent, the adequacy of the consideration test promotes administrative convenience and authorizes the taxation of a wide variety of conveyances. If a transfer arises from arm's length negotiations between parties in the ordinary course of business, however, this test is inappropriate and the transaction will not be considered a gift, regardless of the disparity of consideration.¹⁸ Hence, the gift tax law does not penalize businessmen for making poor bargains.¹⁹

Judicial decisions generally have recognized the broad purposes of the gift tax laws and have upheld the taxation of many direct gifts, including transfers of promissory notes²⁰ and United States savings

Treas. Reg. § 25.2511-1(g) (1) (1958). See *Commissioner v. Wemyss*, 324 U.S. 303, 306 (1945); *Gilbert Pleet*, 17 T.C. 77, 82 (1951).

16. I.R.C. § 2512(b), which provides in pertinent part: "Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift . . ." Further distinguishing a common law gift, the Regulations provide:

Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor.

Treas. Reg. § 25.2512-8 (1958). The consideration must be quantifiable in specific monetary terms; intangible values such as love or moral obligations will be disregarded when determining the amount of a gift. See, e.g., *Commissioner v. Wemyss*, 324 U.S. 303, 305 (1945); *Holzman, The Nature of Taxable Gifts*, 43 TAXES 189, 194 (1965).

17. See note 16 *supra*.

18. "[A] sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth." Treas. Reg. § 25.2512-8 (1958).

19. See *Estate of Monroe D. Anderson*, 8 T.C. 706, 720-21 (1947); D. KAHN & E. COLSON, *supra* note 11, at 256; see generally 5 J. MERTENS, *supra* note 13, at 99.

20. *Brown v. Commissioner*, 241 F.2d 827 (8th Cir. 1957); *Woodward v. United States*, 208 F.2d 893 (8th Cir. 1953).

bonds,²¹ assignments of future income,²² and forgiveness of debts.²³ Similarly, indirect gifts, which include no obvious presentation of property but nevertheless confer a gratuitous benefit on the donee, also may generate tax liability.²⁴ Examples of the latter type of gift are: payment of another's bills, obligations, or expenses;²⁵ transfers for the benefit of a third party;²⁶ creation of partnership interests;²⁷ and disclaimers of inheritance or bequests.²⁸ Moreover, an interest-free loan, providing its borrower with the use of its proceeds without cost, could be characterized as an indirect gift.

THE INCOME TAX ANALOGY

Before *Crown*, the judiciary addressed the issue of the taxability as gifts of interest-free loans only once.²⁹ Nevertheless, the responses of other courts to related questions provide insight for an analysis of the Tax Court's decision in *Crown*. For example, the basic problem of ascertaining whether an interest-free loan transfers a taxable value³⁰ has arisen in the context of similar situations involving income tax issues. Section 482 of the Code authorizes the Commissioner to allocate income among related corporations to reflect ac-

21. Rev. Rul. 68-269, 1968-1 C.B. 399. Although a savings bond's interest is exempt from income taxation, a gift tax may be imposed on any gratuitous transfer of the property itself. See C. LOWNDES & R. KRAMER, *supra* note 8, at 586; 5 J. MERTENS, *supra* note 13, at 19.

22. *Galt v. Commissioner*, 216 F.2d 41 (7th Cir. 1954), *cert. denied*, 348 U.S. 951 (1955); *Lockard v. Commissioner*, 166 F.2d 409 (1st Cir. 1948). *But see* *Emily C. Collins*, 1 T.C. 605 (1943) (no taxable gift to corporation on waiver of preferred stock dividend arrearages).

23. Treas. Reg. § 25.2511-1(a) (1958). See *Estate of Grace E. Lang v. Commissioner*, 64 T.C. 404 (1975).

24. See I.R.C. § 2511(a). "[I]t has been said that it is not necessary to the operation of the gift tax that the donor affirmatively go through the ritual of making a gift. The term 'indirectly' is used in the broadest and most comprehensive sense." 5 J. MERTENS, *supra* note 13, at 78, *citing* *Chase Nat'l Bank*, 25 T.C. 617 (1955), *rev'd on other grounds*, 259 F.2d 231 (5th Cir. 1958), *cert. denied*, 359 U.S. 913 (1959).

25. *Drybough v. United States*, 208 F. Supp. 279 (W.D. Ky. 1962); Rev. Rul. 54-343, 1954-2 C.B. 318.

26. Treas. Reg. § 25.2511-1(h)(2)-(3) (1958).

27. *Commissioner v. Tower*, 327 U.S. 280 (1946); *William H. Gross*, 7 T.C. 837 (1946).

28. *Ianthe B. Hardenbergh*, 17 T.C. 166 (1951), *aff'd*, 198 F.2d 63 (8th Cir.), *cert. denied*, 344 U.S. 836 (1952); Treas. Reg. § 25.2511-1(c) (1958). A "qualified disclaimer" is not regarded as a taxable transfer. I.R.C. § 2518.

29. *Johnson v. United States*, 254 F. Supp. 73 (N.D. Tex. 1966). For a discussion of *Johnson* see notes 49-52 *infra* & accompanying text.

30. See 5 J. MERTENS, *supra* note 13, at 34-35.

curately the earnings of each entity.³¹ Maintaining that the section permits only the allocation of income, rather than its creation,³² courts initially rebuffed the Commissioner's attempts to treat loans of interest-free money or of rent-free equipment as sources of income to the lending corporations.³³ In *B. Forman Co. v. Commissioner*,³⁴ however, the Court of Appeals for the Second Circuit approved the allocation of this type of income if the Commissioner could demonstrate that interest would have been charged had the transaction been conducted at arm's length.³⁵ Imputing interest income to the lender as if the loan actually had been made in a bona fide commercial context,³⁶ the Second Circuit's valuation technique closely approximated the adequacy of the consideration test. Of greater significance, the court's ratification of the Commissioner's decision to subject this imputed interest to income taxation implicitly recognizes that the use value of a loan is a valuable property right. Accordingly, the gratui-

31. I.R.C. § 482 provides in pertinent part:

In any case of two or more organizations, trades, or businesses . . . owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations . . . if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organization

32. "[T]he respondent [Commissioner] has not distributed, apportioned, or allocated gross income, but has created income where none in fact existed." *Smith-Bridgman & Co.*, 16 T.C. 287, 293-94 (1951), *acq.* 1951-1 C.B. 3.

33. *See, e.g., Tennessee-Arkansas Gravel Co. v. Commissioner*, 112 F.2d 508 (6th Cir. 1940); *Huber Homes, Inc. v. Commissioner*, 55 T.C. 598 (1971); *PPG Indus., Inc. v. Commissioner*, 55 T.C. 928 (1970); *Smith-Bridgman & Co.*, 16 T.C. 287 (1951), *acq.* 1951-1 C.B. 3. The Commissioner later explained his acquiescence in *Smith-Bridgman & Co.* as embracing only the principle that § 482 required complementary adjustments to the income of each related corporation. *See Rev. Rul. 67-79*, 1971-1 C.B. 117.

34. 453 F.2d 1144 (2d Cir.), *cert. denied*, 407 U.S. 934 (1972).

35. *Id.* at 1155. The court stated:

To the extent that the above cases cited by taxpayers [*see note 33 supra*] may be read as holding that no interest can be allocated under § 482 . . . they are not in accord with either economic reality, or with the declared purpose of section 482. . . . [I]nterest income may be added to taxpayers' incomes, as long as a correlative adjustment is made to Midtown

Id. at 1156. The holding in *B. Forman Co.* has been followed in *Fitzgerald Motor Co. v. Commissioner*, 508 F.2d 1096 (5th Cir. 1975); *Kerry Inv. Co. v. Commissioner*, 500 F.2d 108 (9th Cir. 1974); *Kahler Corp. v. Commissioner*, 486 F.2d 1 (8th Cir. 1973).

36. *See generally* O'Hare, *The Taxation of Interest-Free Loans*, 27 VAND. L. REV. 1085, 1096-1103 (1974).

tous transfer of this right through a deliberate failure to charge interest should be regarded as a taxable gift.

Corporate-shareholder transactions have presented questions similar to those in *B. Forman Co.* The Commissioner repeatedly has described a shareholder's interest-free or rent-free use of corporate funds or property as a valuable interest that may be taxable either as a constructive dividend or as compensation for services rendered.³⁷ With respect to the rent-free use of corporate property, the courts generally have sustained the Commissioner's position.³⁸ In *J. Simpson Dean*,³⁹ however, the Tax Court held in favor of the borrowers, stating that "an interest-free loan results in no taxable gain to the borrower."⁴⁰ Distinguishing the conflicting precedent established by cases involving the rent-free use of corporate property, the court noted that, in each, the corporation bestowed on the taxpayer a benefit otherwise obtainable only by a nondeductible expenditure.⁴¹ In contrast, if the petitioners in *Dean* had borrowed the money on interest-bearing notes, the interest paid would have been deductible.⁴²

In effect, the court's declaration that a shareholder derives no taxable gain from an interest-free loan merely provides the taxpayer with the benefit of the corresponding interest deduction that would have been available if he had acquired his loan in a commercial money market.⁴³ Presumably, when no offsetting deductions are available, as in the rent-free property use situations, a court should regard use value as a taxable item. Under this rationale, the decision in *Dean* does

37. See, e.g., *Joseph Lupowitz Sons, Inc. v. Commissioner*, 497 F.2d 862 (3d Cir. 1974); *Chandler v. Commissioner*, 119 F.2d 623 (3d Cir. 1941); *Saunders v. United States*, 294 F. Supp. 1276 (D. Hawaii 1968), *rev'd on other grounds*, 450 F.2d 1047 (9th Cir. 1971); *Rapid Elec. Co. v. Commissioner*, 61 T.C. 232 (1973); *Elliot J. Roschuni*, 29 T.C. 1193 (1958); *Paulina DuPont Dean*, 9 T.C. 256 (1947).

38. See, e.g., *Chandler v. Commissioner*, 119 F.2d 623 (3d Cir. 1941); *Elliot J. Roschuni*, 29 T.C. 1193 (1958); *Paulina DuPont Dean*, 9 T.C. 256 (1947).

39. 35 T.C. 1083 (1961).

40. *Id.* at 1090.

41. *Id.*

42. *Id.* Criticizing the Tax Court's decision in *Dean*, one commentator has argued that the shareholder should not be permitted an interest deduction on a loan from his corporation unless the corporation is required to report a corresponding amount of interest income received. O'Hare, *supra* note 36, at 1096.

43. Four concurring judges in *Dean* determined that because this deduction was available the majority had decided unnecessarily that interest-free loans provided no income for borrowing shareholders. 35 T.C. at 1090-91 (concurring opinion). In *Crown*, the dissenting judge adopted this rationale to distinguish *Dean*: "In [*Dean*], we did not hold that the interest-free loan failed to produce income; it was merely held that such loans did not result in taxable income since it was assumed that there would be deductions to offset income." *Crown v. Commissioner*, 67 T.C. 1060, 1070 (dissenting opinion).

not undermine the Commissioner's position in *Crown* that the gratuitous transfer of the use value of money may constitute a taxable gift.

Another group of income tax cases deserves consideration in an analysis of the decision in *Crown*. The judiciary has determined that a gratuitous transfer of the use value of money or property may qualify as a charitable contribution for income tax purposes. As a result, taxpayers validly have deducted from their incomes amounts equal to the rental value of property loaned free to charitable institutions,⁴⁴ regardless of whether the property otherwise would have been rented profitably.⁴⁵ Similarly, taxpayers have been permitted to deduct the use value of low interest loans extended in charitable gift transactions. For example, in *Mason v. United States*⁴⁶ a charity purchased a business for a small down payment and a low interest bearing note having a face amount equal to the balance owed for the property. The Court of Appeals for the Seventh Circuit determined that the difference between the fair market value of the business less the down payment and the discounted value of the note was a deductible charitable contribution.⁴⁷ The court noted:

[T]he gift might be characterized as the value to the charity of the taxpayer's willingness to forego the receipt of the fair market rate of interest on this note over this extended period of time. The fact that the taxpayer will ultimately be paid the principal sum does not mean that the charity has not been benefitted or that the taxpayer has in fact recovered that which he has foregone.⁴⁸

Generally, a gratuitous transfer qualifying for an income tax deduction as a charitable contribution also will be exempt from gift taxation.⁴⁹ Nevertheless, the Code clearly refers to the transaction as a gift.⁵⁰ When an identical transfer fails to qualify for charitable treatment merely because the donee is not an approved recipient, however, the transaction does not cease to be a gift; rather, it never attains a privileged status under the tax laws. Because a low interest or interest-free loan may be characterized as a gift for the purpose of receiving

44. See, e.g., *Threlfall v. United States*, 302 F. Supp. 1114 (W.D. Wis. 1969); *Thriftmart, Inc. v. Commissioner*, 59 T.C. 598 (1973); *John G. Allen v. Commissioner*, 57 T.C. 12 (1971); *Priscilla M. Sullivan*, 16 T.C. 228 (1951).

45. See *Threlfall v. United States*, 302 F. Supp. 1114, 1120 (W.D. Wis. 1969).

46. 513 F.2d 25 (7th Cir. 1975).

47. See *id.* at 30.

48. *Id.* at 30 n.15.

49. Compare I.R.C. § 170(c) (charitable contributions generating deductions from gross income), with *id.* § 2522(a) (charitable transfers exempt from gift taxation).

50. *Id.* §§ 170(c), 2522(a).

favorable income tax consideration, it should be regarded as a gift even though favorable tax consequences are unavailable. Therefore, an intrafamilial interest-free loan should constitute a taxable gift equivalent to the use value of the proceeds.

SPECIFIC GIFT TAX PRECEDENT

Prior to *Crown*, only one court had examined whether interest-free loans to family members are subject to the gift tax. In *Johnson v. United States*,⁵¹ the District Court for Northern Texas held in favor of petitioner who, with her husband, had made substantial interest-free demand loans over a period of years to her adult children.⁵² Although the children repaid most of the loans' proceeds before the husband's death in 1962, the Commissioner nevertheless assessed a gift tax deficiency for the years 1956 to 1962 based on the use value of the outstanding principal.⁵³ The district court rejected the Commissioner's assessment, concluding that the purpose of the gift tax, to avoid depletion of estates through inter vivos giving, was not defeated because the loan's principal remained in the gross estate.⁵⁴ According to the court, the law required a parent neither to deal at arm's length with his children nor to charge them interest on loans; only congressional action could impose such an obligation.⁵⁵

The Internal Revenue Service did not comment on the decision in *Johnson* until 1973, when it issued Revenue Ruling 73-61.⁵⁶ Adopting the Congressional test that deems property transferred "for less than

51. 254 F. Supp. 73 (N.D. Tex. 1966).

52. During the seven-year period the balance due on the loans averaged over \$500,000. See *id.* at 75-76.

53. The Commissioner defined the gift to be equivalent to sums of 3½% of the average annual unpaid balance. *Id.* at 76.

54. *Id.* at 77.

55. *Id.* In *Harris v. Commissioner*, 340 U.S. 106 (1950), the only case cited by the district court in *Johnson* to support its decision, the Supreme Court stated that the purpose of the gift tax was "to complement the estate tax by preventing tax-free depletion of the transferor's estate during his lifetime." *Id.* at 107. In its simplistic opinion, however, the court in *Johnson* failed to consider adequately the relationship between the gift and income taxes, the statutory language, and the actual effect of the interest-free transfer on the taxpayer's estate. Several articles criticized both the result in *Johnson* and its potential effects. See O'Hare, *supra* note 36, at 1088; Note, *The Value of the Use of Money Loaned by Taxpayers to Their Children Without Interest Does Not Constitute a Gift*, 5 HOUS. L. REV. 138 (1967); 65 MICH. L. REV. 1014 (1967); 19 STAN. L. REV. 870 (1967).

56. 1973-1 C.B. 408. In this ruling the taxpayer received a \$200,000 loan from a bank. Subsequently, he lent \$250,000 interest-free to his son's wholly-owned corporation, the bulk of the proceeds to be payable on demand and the remaining \$50,000 to be due in ten years.

an adequate and full consideration”⁵⁷ to be a gift, the Service ruled that the recipient of a loan acquires a property interest in the use of money, which is taxable as a gift “unless full and adequate consideration in money or money’s worth is received.”⁵⁸ In his ruling rejecting the holding in *Johnson*, the Commissioner relied on *Gertrude H. Blackburn*,⁵⁹ a 1953 Tax Court decision that involved a bargain sale-gift of property from petitioner to her children. In *Blackburn* the petitioner paid a gift tax on the difference between the fair market value of the property and the amount payable on the note she received for her real estate. The Tax Court, however, upheld the Commissioner’s decision to require the petitioner to pay an additional gift tax on the difference between the note’s fair market value and its discounted value, an amount calculated from the variance between the commercial interest rate and the low interest rate of the note.⁶⁰

Revenue Ruling 73-61 followed logically from *Blackburn*: if a family transaction for inadequate interest may be taxed as a gift, then an interest-free transfer also should be taxable. Although the ruling relied upon a 1953 Tax Court decision, it provided the first notice that the Commissioner would not follow the district court’s holding in *Johnson*, which had been decided seven years earlier.

CROWN V. COMMISSIONER

The petitioner in *Crown* and his two brothers were equal partners in Areljay Company (Areljay). Areljay loaned substantial amounts of money to twenty-four trusts, the beneficiaries of which were the partners’ children and other close relatives. By the end of 1967, loans to the trusts represented by demand notes exceeded two million dollars, with interest to be paid at six percent per annum only after demand. In addition, interest-free sums lent on open account totalled nearly sixteen million dollars.⁶¹ The Commissioner determined that the use value of the loaned funds constituted a taxable gift. Regarding six percent as a reasonable rate of interest, he computed the amount of the gift to be in excess of one million dollars, one-third of it attributable to petitioner.⁶²

The Tax Court resolved the issue, “whether interest-free loans to relatives of the lender (or trusts for the benefit of such relatives) give

57. *Id.*, citing I.R.C. § 2512(b).

58. Rev. Rul. 73-61, 1973-1 C.B. 408, 409.

59. 20 T.C. 204 (1953).

60. *Id.* at 207. The interest rate on the note was 2¼%; the fair market rate imposed by the Commissioner was 4%. *Id.* at 205.

61. 67 T.C. at 1061.

62. The Commissioner deemed petitioner’s gift to be \$362,135.92. *Id.* at 1061-62.

rise to taxable gifts from the lender to the borrowers to the extent of the value of the use of the funds loaned,"⁶³ in favor of the petitioner. Expressly approving the district court's analysis in *Johnson*, the Tax Court acknowledged that the gift tax was intended to deter the avoidance of federal estate taxes.⁶⁴ In both *Crown* and *Johnson*, however, the estate ultimately could recover the principal of the loans. Therefore, insofar as the federal tax system requires neither the recognition of unrealized income nor the constant reinvestment of wealth, a refusal to charge interest on loans could not be regarded as depleting the estate.⁶⁵ Thus, the unrealized use value of a loan could not be considered a taxable gift.⁶⁶

Writing for the majority in *Crown*, Chief Judge Dawson reviewed several decisions in which the judiciary had declined to impose an income tax on non-interest bearing loans and concluded that the courts uniformly had rejected all attempts by the Internal Revenue Service to levy either income or gift taxes on those loans.⁶⁷ The court also foresaw numerous administrative problems that would accompany a decision to subject the permissive use value of intra-familial property sharing to gift taxation.⁶⁸ Further, the Tax Court appeared to recognize that the Commissioner's failure to announce his position regarding interest-free loans before the issuance of Revenue Ruling 73-61 in 1973, seven years after the decision in *Johnson*, could place an unfair tax burden on those who had relied on the district court's decision.⁶⁹ Accordingly, the court concluded that any decision expanding the scope of the gift tax to encompass the disputed transactions must be made by Congress.⁷⁰

Dissenting with three other judges, Judge Simpson concluded that Congress intended section 2512(b) of the Code "to reach any gratuitous transfer of any interest in property," including the conveyance of the privilege of using money.⁷¹ Because the loans had not been made in the ordinary course of business, the sole issue was "whether the value of the property transferred exceeded the value of the consideration furnished."⁷² Thus Judge Simpson determined that the peti-

63. *Id.* at 1060.

64. *Id.* at 1063-64.

65. *Id.*

66. *Id.*

67. *Id.* at 1064.

68. *Id.* at 1065.

69. *Id.* at 1063.

70. *Id.* at 1065.

71. *Id.* at 1066 (dissenting opinion). For the relevant text of § 2512(b) see note 16 *supra*.

72. 67 T.C. at 1067.

tioners, having received no consideration for the loans, made gifts equal to the use value of the money they transferred.⁷³

The dissent also objected to the court's conclusion that the Commissioner's position would create administrative problems and disrupt many family transactions.⁷⁴ Recalling that the \$3,000 annual exclusion permitted by section 2503(b)⁷⁵ would exempt the usual intra-familial transfer from taxation, Judge Simpson concluded that only those extraordinary transactions involving large sums of money, as in *Crown*, would be subject to gift taxation.⁷⁶

EFFECTS OF THE DECISION IN CROWN

The Tax Court's decision in *Crown* creates a valuable tax avoidance opportunity for those persons with large amounts of cash in their estates. By making interest-free demand loans, a lender may permit the investment of his money without acquiring income tax liability for the resulting earnings. This consequence is desirable for a lender who is in a higher income tax bracket than are the recipients of the earnings from the invested money. Because the earnings will be subject to a lower income tax rate than if the lender had invested the money himself, the recipients will receive a larger portion of the return on the investment. Not only will the lender avoid income taxes but he also may reduce the total amount of his estate subject to federal death taxes because he probably would have made an income-producing investment in lieu of an interest-free loan.⁷⁷

Permitting the avoidance of both income and estates taxes, an interest-free demand loan appears to be the type of transaction that Congress intended to subject to the gift tax laws⁷⁸ and that the courts have subjected to its provisions.⁷⁹ Moreover, other transactions identical in substance to interest-free loans, although different in form, are taxable as gifts. Thus, if the taxpayer invests the money, he

73. *See id.* at 1069.

74. *Id.* at 1070.

75. I.R.C. § 2503(b).

76. 67 T.C. at 1070.

77. *See* O'Hare, *supra* note 36, at 1088.

78. *See* note 2 *supra* & accompanying text.

79. *E.g.*, Commissioner v. Wemyss, 324 U.S. 303 (1945) (antenuptial property settlement is gift if only consideration is love); Helvering v. Horst, 311 U.S. 112 (1940) (transfer of interest coupons detached from bonds is taxable gift, with income from coupons taxable to donor); Sanford's Estate v. Commissioner, 308 U.S. 39 (1939) (inter vivos transfer of property in trust with reserved powers of appointment is completed gift when power relinquished); Commissioner v. Hart, 106 F.2d 269 (3d Cir. 1939) (creation of estate by entireties is gift); Rev. Rul. 54-243, 1954-1 C.B. 318 (father's payment of adult son's expenses is gift).

would be required to pay not only income taxes on the investment's earnings but also gift taxes on the amounts transferred to his donees. In addition, if the taxpayer establishes a short-term or a revocable trust for the benefit of another, he may be liable for both income and gift taxes on the amounts produced by the corpus.⁸⁰ A taxpayer also may be subject to gift taxation if he makes a low interest loan,⁸¹ forgives a debt,⁸² or permits the statute of limitations to run on the collection of a payment.⁸³ Although interest-free loans logically should receive tax treatment similar to these transactions, the Tax Court repudiated such a possibility in *Crown*.

Although the Tax Court in *Crown* nearly overruled its earlier opinion in *Gertrude H. Blackburn*,⁸⁴ the majority's failure to refer to *Blackburn* suggests that it regarded *Blackburn*'s facts as distinct from those of *Crown* and not controlling in the latter case. As a result, a taxpayer hoping to acquire the permissible tax benefits authorized in *Crown* must avoid structuring a transaction similar to that involved in *Blackburn*. The pertinent facts in *Crown* differ from *Blackburn* in two respects: first, *Blackburn* involved a low interest loan as opposed to the interest-free transaction in *Crown*; second, the indebtedness in *Blackburn* was represented by a note for a period of years whereas the loans in *Crown* could be collected on demand. Although these two differences appear to be irrelevant,⁸⁵ inasmuch as the decision in *Crown* is not well-reasoned, they are meaningful and must be recognized by the taxpayer who makes interest-free loans.

Regarding the first distinction, the only difference between the two cases is that the aggregate amount of a gift structured under *Blackburn* would be less because some interest is charged. The second distinction between the two cases, the type of note used in the transaction, is meaningful only insofar as it determines the time and value of the gift. Because the loan in *Blackburn* was for a term of years, the Commissioner initially could determine the discounted value of the note and compute the entire amount of the gift. In *Crown*, however, the demand note could not be discounted because its due date was uncertain. As a result, the Commissioner could not calculate at once the

80. *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Clifford*, 309 U.S. 331 (1940); *Corliss v. Bowers*, 281 U.S. 376 (1930). See also 19 STAN. L. REV. 870, 875-76 (1967).

81. See text accompanying notes 59-60 *supra*. See also Walter H. Sutliff, 46 B.T.A. 446 (1942).

82. Treas. Reg. § 25.2511-1(a) (1958).

83. *Estate of Grace E. Lang v. Commissioner*, 64 T.C. 404 (1975).

84. For a discussion of *Blackburn* see text accompanying notes 59-60 *supra*.

85. See *Crown v. Commissioner*, 67 T.C. 1060, 1068 (1977) (dissenting opinion).

entire amount of the gift; instead, in accordance with Revenue Ruling 73-61,⁸⁶ he logically determined that a gift of the use value of the money was made in each quarter that the loans were outstanding. The requirement that the gift from a single transaction be computed in a number of successive quarters might have formed the basis for the Tax Court's decision in *Crown*.⁸⁷ Although the method of calculating the amount of the gift usually is not determinative of whether a gratuitous transfer actually was made, the court's refusal to permit the taxation of interest-free demand loans may have resulted directly from its recognition that such a practice would be administratively unmanageable and would encroach upon intrafamilial transactions.⁸⁸

CONCLUSION

The gift tax provisions require the imposition of a tax on most transfers of valuable interests for inadequate consideration. Although the use value of money is capable of measurement and should be regarded as a taxable interest, the Tax Court in *Crown v. Commissioner* rejected this proposition by exempting interest-free demand loans from gift taxation. Nevertheless, because the courts of appeals have not yet decided this issue, a taxpayer should be cautious in exploiting the tax avoidance opportunities created by the court in *Crown*.

86. 1973-1 C.B. 408. For a discussion of Revenue Ruling 73-61 see notes 56-60 *supra* & accompanying text.

87. Actually, because the taxpayer's may compute the gift in successive quarters, I.R.C. § 2503(b) permits him to exclude annually from gift taxation as much as \$3,000 of the total gift to each donee. Thus, at a 5% commercial interest rate, a \$60,000 interest-free demand loan would subject its donor to no gift tax liability. In contrast, if the loan was made for a term of years, the total gift would be equal to the difference between the aggregate amount of the debt and the discounted value of the note, and the donor could benefit from the \$3,000 exclusion authorized by § 2503(b) only in the loan's initial year.

88. 67 T.C. at 1065. The court's decision deviates from the longstanding judicial practice of carefully reviewing those intrafamilial transactions that may be subject to the tax laws. *See, e.g.*, *Helvering v. Clifford*, 309 U.S. 331, 335 (1940); *Sax Rohmer*, 21 T.C. 1099, 1104 (1954); *William H. Gross*, 7 T.C. 837, 847 (1946).