M e m o r a n d u m

125.0070

To: Mr. Glenn Bystrom Date: April 28, 1987

From: Donald J. Hennessy
Senior Tax Counsel

Subject: Transfers of Autos by Corporations to Employees, Shareholders, or Third Parties as "Gifts" or "Purchases"

On April 17, 1987, Assistant Chief Counsel Gary Jugum, Senior Tax Counsel E. L. Sorensen, Jr., and I met to discuss the above referenced topic. I am attaching a copy of my April 10, 1987 memo to Mr. Sorensen on the same topic, which memo was used as the basis of our discussion. The conclusions we reached may be classified into the same three categories as in my April 10, 1987 memo, i.e., (1) Transfers to corporate employees, (2) Transfers to corporate shareholders (including doctors, lawyers and CPAs) owning closely held corporations, and (3) Transfers to persons not directly related to the corporation (e.g., daughter of sole shareholder of corporation).

1. Transfers to corporate employees.

We believe our basic approach on such transfers is as state in Annotations 125.0040 and 280.0140. Transfers to employees as a bonus, even if an annual custom, and therefore expected by employees, are not sales or purchases. A copy of the corporate minutes, or a written statement from [X] responsible corporate official raifying the gift to the employee, will suffice as proof. Of course, any transfer for which consideration, such as cash or assumption of laibilities, is given by the transferee, is not a gift, and tax applies.

Regarding this conclusion, you may wish to review the first paragraph on page 2 of your May 19, 1986 memo to all District Administrators. In our opinion, the reporting of the transfer as income on a W2, 1099, or 599 for federal or state income tax purposes is of little relevance in deciding if such a transfer is a "sale" and "purchase". to conclude that such bonus transfers are sales and purchases directly conflicts with Annotations 125.0040 and 280.0140.

2. Transfers to corporate shareholders (including doctors, lawyers and CPAs) owning closely held corporations.

Again our conclusion here was that an annotation, this time Annotation 495.0725, gives the correct result, i.e., if the parties follow the dividend in kind procedure from the annotation, the transfer is not a sale or purchase. Again, a copy of the corporate minutes declaring the divdend, or a written statement from the shareholder raifying the dividend, would be sufficient proof. If the dividend-in-kind procedure is not followed, the taxpayer must explain how the

transfer was recorded in the corporate records, although we suspect this will often only lead to the same result as in one (1) above.

We believe the two petition cases ([X1] and [X2]) referred to on page 3 of my April 10, 1987 memo to Mr. Sorensen should be investigated further according to these guidelines and, unless traditional consideration, such as cash or assumption of laibility is present, should be granted. By copy of this memo to Darlene Hendricks of the Petition Unit, I am informing her of this recommendation on the two petitions.

3. Transfers to persons not directly related to the corporation (e.g., daughter of sole shareholder of coporation)

Assuming that we cannot show any of the traditional types of consideration, such as cash or an assumption of liabilities, we cannot show a “sale” and “purchase”, and no tax would apply to such transfers.

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In general, the above conclusions are admittedly a step back from the rule stated in your September 12, 1986 memo to District Administrators, under which the expectation was that they would rarely find a true gift occurs when the transfer of the vehicle is from a corporation to its employee. While such expectation makes for a hard and fast rule of easy application for the field staff, our study and discussion of the issue just does not furnish an adequate legal basis for the expectation. As is discussed in some length in my April 10, 1987 memo to Mr. Sorensen, we often simply cannot establish the bargained for consideration, i.e., the sales price paid by the transferee in these transfers of automobiles. Even in the cases involving a closely held corporation, in which a single shareholder may control both the transferor and the transferee side of these transfers, we must keep in mind our insistence on the separate legal entity doctrine, and find a bargained for price within a contract of sale.

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cc: Mr. Gary J. Jugum
Mr. E. L. Sorensen, Jr.
Ms. Darlene Hendricks

Memorandum

125.0070

To: Mr. E. Leslie Sorensen, Jr. Date: March 2, 1987

From: David H. Levine

Subject: Transfer of autos by corporation as gift or income to transferee

This is in response to your request for my opinion regarding the evidence necessary to establish that a corporation's transfer of an auto to an employee is a gift as opposed to income to the employee. If income to the employee, the transfer would be subject to use tax.

This question was originally asked by the Occasional Sales Unit in a memorandum dated March 25, 1985. You responded in a memorandum dated January 13, 1986, explaining the essential elements of a gift. You also explained that a simple "gift statement" from the corporation/transferor would not alone be sufficient to establish that the transfer were a gift not subject to use tax. You noted that we would accept a ruling issued by the IRS that the transfer was a gift as establishing that the transfer was a gift not subject to use tax.

After receiving your memorandum, the audit staff would not accept a transfer of an auto by a corporation to its employee as a gift for use tax purposes unless the employee obtained an IRS or FTB ruling that the transfer were a gift for income tax purposes. However, the IRS and FTB apparently will not issue such rulings. You have therefore asked what, if any, documentation would be acceptable to establish that a transfer is a nontaxable gift.

A similar analysis is required to determine whether the value of a transfer of property is exempted from federal income tax as a gift under Internal Revenue Code section 102. It is therefore appropriate to review cases interpreting that provision to assist us in our analysis.

In Commissioner v. Duberstein ((1960) 363 U.S. 278, 4 L.Ed. 2d 1218), the U.S. Supreme Court refused to set forth a simple test for determining whether a transfer constitutes a gift. Rather, the court held that the determination "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." (Id. at 289, 4 L.Ed. 2d 1227.)

The Court noted that a transfer proceeding primarily from the impulsion of a moral or legal duty, or from the incentive of an anticipated economic benefit, is not a gift. The most critical element is the transferor's intent, and this determination requires an inquiry into the dominant reason for the transfer. (Id. at 285-86, 4 L.Ed. 2d 1224-25; see U.S. v. Kasynski (10th Cir 1960) 284 F.2d 143, 146.) Only if the transfer is due to a detached and disinterested

generosity, out of affection, respect, admiration, charity or like impulses will it be considered a gift. (Duberstein, 363 U.S. 285, 4 L.Ed. 2d 1225.)

Based on the above, I do not believe it possible to set forth specific documents (outside of FTB and IRS rulings) that someone can present to us to establish that the transfer of an auto is a nontaxable gift. Rather, the burden is on the potential taxpayer to show the transfer is not taxable, and he must present any evidence he believes shows the transfer to be a gift. The person from our staff must examine the evidence and make a case by case determination of the dominant reason for the transfer. Below I note several other general principles upon which our determination should be based.

The corporation's characterization of a transfer, while relevant, is not controlling or determinative. (Gaugler v. U.S. (2d.Cir. 1963) 312 F.2d 681, 685.) Simply denominating a transfer as a "gift" would not alter reality, just as calling it "compensation" would not alone be effective to make it such; rather, substance and not form must prevail in each case. (Bounds v. U.S. (4th Cir. 1958) 262 F.2d 876, 882.)

The most important aspect of the situation at issue is that the transfer is from a corporation to its employee. In Carragan v. Comm'r of Internal Rev. ((2d Cir. 1952) 197 F.2d 197), the plaintiff received an allowance, in addition to his salary, which he claimed was a gift. The court stated that there is a "presumption" that an employer gives such an allowance to a present employee for services rendered and not out of altruism. (Id. at 249.)

In Gaugler, supra, a corporation gave its deceased president's widow a sum equal to what the president's salary would have been during the remainder of the year of his death. The court upheld the trial court's conclusion that the payments were taxable income to the widow because the trial court had considered a number of factors that were clearly relevant, including the fact that the payments were made by a business corporation and that sound business reasons were considered in making them. (312 F.2d 684.)

The Occasional Sales Unit first asked this question in response to a reaction by some corporations to a certain IRS ruling. Because of the ruling, corporations began transferring autos owned by the corporations to their employees. I believe this reason is sufficient to assess a tax on such a transfer because it is clearly done for sound business reasons and not for reasons of detached and disinterested generosity, etc.

Another example of a transfer I believe is subject to use tax is represented by [X] request for waiver dated September 9, 1986. The corporation transferred the auto to the corporation's sole owner in order to obtain lower insurance rates. The corporation's transfer is for a sound business reason and not out of disinterested generosity. The transferee presumably obtains the auto subject to the obligation of using it for the corporation's business. This is not a gift. (See your memo (gift involves complete divestment by donor of all control of property transferred).)

I agree that an IRS or FTB ruling that a transfer is a gift should be sufficient to establish the transfer as a gift for use tax purposes. I also believe that a tax return filed by the transferee excluding the auto from the transferee's income as a gift should be sufficient to establish the transfer as a gift for use tax, provided, however, that the return has withstood an audit on that particular issue. This obviously would only be for purposes of a use tax refund. Short of these methods, I believe that the burden of showing us that an auto transferred from a corporation to its current employee is substantial. Realistically, I believe that such a gift transfer would be so rare as to entitle us to presume in all such cases that the transfer is not a gift provided that we fairly review any evidence the parties can present to show that it was a gift.

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