

Redstone: Tax Court Upholds a 43 Year Old Gift Tax Deficiency

In December 2015, the Tax Court rendered its opinion on *Sumner Redstone v. Commissioner of Internal Revenue*. The focus of the dispute was whether a stock transfer made by Sumner Redstone in 1972 was a gift for Federal gift tax purposes, or, as Sumner Redstone claimed, was a transfer for “adequate and full consideration in money or money’s worth.”¹ Following an examination that concluded in early 2013, the IRS issued against Sumner Redstone a gift tax deficiency of \$737,625 for the calendar quarter ending September 30, 1972.² In addition, the IRS determined an additional \$368,813 for fraud,³ \$36,881 for negligence,⁴ and \$184,406 for failure to file a timely gift tax return.⁵ Ultimately, after a trial, the Tax Court found that the transfer was a taxable gift but Sumner Redstone was not liable for any additional penalties.

The background to this case has a long and storied path, mired by intra-family lawsuits and infighting. As a result of a settlement agreement born out of litigation between Sumner Redstone, Michael Redstone (Sumner’s father), and Edward Redstone (Sumner’s brother), it was decided that the company originally founded by the three parties (National Amusements, Inc. or “NAI”) would repurchase Edward’s stock. Sumner and Michael would remain involved in the company, with Sumner becoming the majority shareholder. In addition, it was agreed that a portion of stock deemed to be owned by Edward (the ownership of which was a subject of dispute) would be placed in trust for the benefit of Edward’s children. The settlement agreement was dated June 30, 1972. The parties agreed that Edward’s shares were to be valued at \$5 million and that a redemption agreement would be executed simultaneously. Because the trusts (and the transfers thereto) set up for the benefit of Edward’s children were stipulated as a result of a settlement agreement associated with litigation, this transaction was not considered to be a gift for federal gift tax purposes. Edward had only agreed to the establishment of the trusts because that was the only way to appease Michael Redstone and end the litigation. Under this condition, the transfer is not a gift but a “transfer of property made in the ordinary course of business.”⁶ Because Edward was forced to

¹ IRC Section 2512(b)

² In 1972, gift taxes were imposed quarterly.

³ IRC Section 6653(b)

⁴ IRC Section 6653(a)

⁵ IRC Section 6651(a)(1)

⁶ IRC Section 25.2512-8

relinquish his claim on the shares transferred to his children in order to settle the litigation and receive ownership of the remaining shares (not subject to the transfer to the trusts), it is assumed that the transfer was made for “full and adequate consideration in money or money’s worth.”⁷

Fast forward three weeks from the settlement agreement to July 21, 1972. On this date, Sumner set up trusts for his two children. At the same time, NAI re-issued shares to each of the trusts that were originally registered in Sumner’s name. The re-issuance of shares to each trust was the exact same amount of shares that were put into each of the trusts for Edward’s children. Based in part on advice that Sumner received from his accountant, who was a partner at a national accounting firm, neither Sumner nor his wife filed a gift tax return for the calendar quarter ending September 30, 1972. It is a little unclear as to why Sumner’s advisors assumed that no gift tax return was required. His accountant was deceased at the time of the trial, and the supposed advice document could not be located. It can only be surmised that Sumner’s advisors assumed that, similar to the transfers made by Edward as a result of the litigation settlement agreement, the transfers were made in the ordinary course of business and no taxable event had transpired.

In 2010, as a result of certain other litigation involving the Redstone family, the IRS became aware of the 1972 transaction and it commenced a gift tax examination in May 2011. The IRS completed its review and issued a notice of deficiency on January 11, 2013 for the aforementioned amounts. Sumner petitioned the Tax Court on April 10, 2013.

The Redstone camp offered up many arguments as to why the deficiency was not valid. However, in its opinion, the Tax Court found that because Sumner Redstone did not file a gift tax return reporting the 1972 transfer, the notice of deficiency was timely. This decision was based upon IRC Section 6501(c)(3), which states that in the case of failure to file a return, the tax may be assessed at any time. The Tax Court further stated that the IRS had not become aware of the 1972 transfers until 2010 and had commenced examination within a reasonable time thereafter. Further, even though Sumner Redstone’s political contributions during the 1970 – 1972 time frame had been investigated by the IRS in 1974, the Tax Court declined to set aside the claimed deficiency based on the argument that a taxpayer should only be subjected to one inspection of its books of account for each taxable year.⁸ The Tax Court was apparently not convinced that a full examination of Sumner Redstone’s books of account had been effectuated in 1974. In addition, the Tax Court stated that the IRS is free to conduct a second examination so long as it notifies the taxpayer in writing that an additional inspection is necessary. Finally, the Tax Court had no doubt that the Sumner Redstone transfers should be categorized as gifts to the associated trusts. Judge Albert

⁷ Ibid.

⁸ IRC Section 7605(b)

Lauber's opinion states the following: "[Sumner's] transfer of stock to his children was undoubtedly prompted by the Settlement Agreement, both as to its timing and its terms, and this transfer surely pleased

[Michael Redstone] by ensuring the financial security of his four grandchildren on equal terms. But this is not enough to make it a transaction 'in the ordinary course of business.' Pleasing parents, like pleasing children, is presumptively a family motivation, and we discern no evidence tending to rebut that presumption here. There was no claim against Sumner; there were no arm's-length negotiations; and he received no consideration from anyone in exchange for his transfer."

In deciding upon the proper value for the transfer and, thus, the resulting tax due, the Tax Court agreed with the IRS expert who relied upon the value determined in the litigation settlement three weeks prior. The Redstone expert had relied upon a so-called engrafting method, which used ratios developed from a price determined in a redemption of NAI shares in 1984.

Finally, the Tax Court decided against the IRS's assertion on fraud, negligence, and failure to file a timely gift tax return. It was the Court's opinion that his failure to file a return was not negligent because he relied in good faith on advice from a tax professional that no tax liability existed and that no return was required.

MPI Commentary:

In a bizarre twist of circumstances, Sumner Redstone is on the hook for not filing a gift tax return for an event that transpired 43 years ago. The statute of limitations for gift tax applies after three years, at which point, it is tentatively assumed that the IRS can no longer pursue a taxpayer for taxes associated with a gift. However, as the Redstone case aptly points out, the statute of limitations is only triggered if the taxpayer files a gift tax return. If no gift tax return is filed, the statute does not apply and the IRS can pursue the taxpayer at any time. Despite the fact that Sumner Redstone relied upon his lawyers and accountants to advise him that the 1972 transaction required no gift tax filing, he was ultimately found responsible for the tax. However, the Tax Court did relieve Redstone of the additional penalties requested by the IRS. Nevertheless, a lot of time and money could have been saved had the experts erred on the side of caution and conservativeness by getting an independent valuation and filing a gift tax return.

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