Thomas-Crow Affair Highlights 'No Man's Land' in Gift Tax Law

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By Jonathan Curry

The exorbitantly friendly interactions between billionaire Harlan Crow and Supreme Court Justice Clarence Thomas shine a light into the world of potentially gift-tax-triggering luxury transactions that go largely unnoticed by both taxpayers and the IRS.

Estate planners generally agree that some of Crow's favors to Thomas should have come with gift tax obligations. But if the real estate tycoon thought to report those taxable gifts at the time, he'd be a rare breed of billionaire.

"I think in most cases clients don't ask the question, and the lawyers don't answer the question," said one estate planner, who requested not to be named. That blind eye apparently also extends to the IRS, the practitioner continued, observing that in their decades of experience, they had never even heard the question of a taxable vacation with family or friends come up during an IRS exam.

That experience was echoed by others in the estate planning community, who said those situations rarely come up in conversations with clients.

Austin Bramwell of Milbank LLP said that for most taxpayers, gifts to friends are more than covered by the annual exclusion, currently set at $17,000 per year, per recipient. "That's a lot of tabs, if all you are doing is buying your friends cups of coffee or inviting them out to dinner," he said.

Robert Lord, a policy adviser with Patriotic Millionaires and a former estate planner, similarly said he couldn't recall a client having ever asked him about the taxability of an instance of luxury hospitality. "You have to get into fairly exotic stuff before you run into this," he observed, noting that with the per-donee annual exclusion, bringing two guests along for a vacation doubles the limit to $34,000 before it becomes a reportable gift.

Best Friends

The interactions between Crow and Thomas — which Thomas failed to report in his financial disclosures — were first reported in a series of articles published beginning April 6 by *ProPublica* that described many instances of the Thomases vacationing with Crow at his resort properties and traveling on his private jet and yacht, some of which would surely have exceeded the value of the annual exclusion. *ProPublica* estimated that the cost of one trip in 2019, when the Thomases flew to Indonesia on Crow's jet and spent nine days island hopping on his superyacht, would've been at least $500,000 if Thomas had booked the trip on his own.

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Further reporting described payments by Crow for Thomas's grandnephew's tuition at two different boarding schools, as well as Crow's purchase of Thomas's mother's home, which he then had renovated and allowed her to live in rent free for several years.

It's widely agreed that the tuition payment likely fell under the section 2503(e) gift tax exception for payments for another's tuition, as long as it was just for tuition and not used to pay for other expenses like room and board. On the other hand, the house purchase and renovation "are more clearly on the taxable gift side of the divide" if, in fact, Thomas's mother wasn't paying rent, according to Daniel Hemel of the New York University School of Law.

But it's the luxury vacations that pose the most challenging questions. Those "fall into a regulatory no man's land," Hemel told *Tax Notes*.

The potential gift tax consequences of those situations weren't lost on Senate Finance Committee Chair Ron Wyden, D-Ore., who quickly issued a letter to Crow requesting that he supply the committee with a clear accounting of any Form 709 federal gift tax returns reflecting gifts to Thomas or his family. Crow has so far declined to comply, and Wyden has suggested — though stopped short of officially announcing — that he might subpoena the records.

Section 6103 of the tax code permits the Finance Committee chair to review any tax returns or tax information from the IRS. However, that information cannot be publicly disclosed without the consent of the taxpayer or through action of the full committee.

For Hemel, though, the IRS clearly hasn't made luxury vacations an enforcement priority thus far, and cracking down on Crow now could be problematic. "If the IRS went after Crow on that basis, Crow could say — with some justification — that he's being treated differently from similarly situated taxpayers," he argued.

Making the Case

By law, the gift tax only applies to transfers of property, but what constitutes a transfer of property can be surprising.

In *Dickman v. Commissioner*, 465 U.S. 330 (1984), the Supreme Court held that interest-free demand loans by a couple to their son were, indeed, transfers of property because there was a "measurable economic value associated with the use of the property transferred."

In Wyden's initial letter to Crow, he invoked *Dickman* to argue that it's clear that the free use of property — like a seat on a billionaire's private jet — constitutes a taxable gift that should be reported.

However, that's taking a maximalist position, and it's not one that the IRS has historically taken, according to Bramwell. In Wyden's view, "every free use of property needs to be reported as a gift," he said.

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Citing *Dickman* may also backfire for the Senate's top taxwriter, Bramwell continued.

The Court was warned of a slippery slope, such that "routine neighborly or familial gifts" would trigger gift tax consequences under its holding. The Court's majority offered an extraordinary response to that concern, Bramwell said. It first acknowledged that it's "not uncommon" for families to provide their children with the use of things, like a car or vacation cottage. It then went on to state: "We assume that the focus of the Internal Revenue Service is not on such traditional familial matters."

Rather than argue that those kinds of interactions shouldn't be taxed as a matter of law, the Court "usurped the role of the executive branch . . . [and] pretended for a moment to act as IRS Commissioner," Bramwell said. "Since *Dickman*, the IRS has, not surprisingly, not in fact devoted much, if any, enforcement efforts in this area."

Rules of Thumb

The Court in *Dickman* put forward that "when the Government levies a gift tax on routine neighborly or familial gifts, there will be time enough to deal with such a case." Four decades later, that still has yet to happen in either guidance or case law, although a few cases have nibbled around the edges.

Justin Miller of Evercore Wealth Management noted that the Tax Court explored a similar issue in *Wineman v. Commissioner*, T.C. Memo. 2000-193 (2000), finding that the taxpayer, a cattle rancher, made taxable gifts to her children when she rented ranch properties to them at below-market rates, forgoing the income she otherwise could have earned from the properties.

Miller said one factor to consider is that the property at issue in *Dickman* and *Wineman* was commercial property. "If you let someone use commercial property rent free that could reasonably be used as a rental, you could say, 'Hey, you're giving up on the rent — that's a gift,'" he said, observing that that would seem to apply to the situation involving Thomas's grandmother's home.

The Court's analysis in *Dickman* that family situations that are "not uncommon" shouldn't be the IRS's focus raises the question of how to determine what kind of situations fall into that category. "You might have friends and family stay in your spare bedroom — that's not uncommon," Miller said. "But is it uncommon to allow people — especially not your adult children, like random friends — to use this property? That might fall under a *Dickman* or *Wineman* analysis," he suggested.

Whether the taxpayer is present could be another key factor, according to Miller. If a hypothetical taxpayer invites a friend to join him at his home or brings the friend with him on his yacht or private jet while he's present and not getting anything in return for it, that's unlikely to be a reportable gift, he said.

"But if you allow them to use it while you're not there, it theoretically could be a gift," Miller said.

What's Next?

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Observers agreed that some proper direction from the government is needed, whether through a public awareness campaign to inform the public of their gift tax obligations or through official guidance.

Hemel said there's a "strong case" for the IRS and Treasury to issue guidance in this area, adding that that's preferable to the IRS going after Crow in this instance.

"Surely it would be better for Treasury and the IRS to articulate that policy through regulations, revenue rulings, and other guidance of general applicability rather than through one-off enforcement actions against high-profile individuals who are associated with the opposition political party," Hemel said.

Although regulations would be welcome, drawing up guidance wouldn't be easy, according to Lord. The IRS would have to contend with the policy challenge of figuring out where to draw the line on the taxability of shared luxury vacations and other forms of hospitality, as well as the practical side of how to enforce it, he said.

Gifts don't have to be reported unless the cumulative value of the gifts given to an individual exceeds the annual exclusion, which could make it challenging for the IRS to identify a potentially taxable pile of transactions, absent a tip from a whistleblower.

"I think it would be hard to track, but it nevertheless would be worthwhile to have regulations addressing it," Lord said. But in doing so, the IRS may have to wrestle with some sensitive questions, like whether, for example, taxable instances of hospitality include the dating context.

"I suspect there are rich people who, over the course of a year, easily could spend more than the $17,000 exclusion amount on someone they're dating. That seems kind of awkward. And how in the world would you enforce it?" Lord wondered.

Follow Jonathan Curry (@jtcurry005) on Twitter for real-time updates.

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