6 T.C. 609 (1946)

When property is transferred to a charitable organization in exchange for an annuity, the taxable portion of the annuity is determined by the original cost of the annuity, and the taxpayer must prove the portion of the transfer intended as a gift to reduce their tax burden.

Summary

Elizabeth Beattie received annuity payments from Mount Union College following her husband's death. The annuity stemmed from a 1927 agreement where she and her husband transferred property to the college. Beattie argued that a portion of the original transfer constituted a gift and should reduce the taxable amount of the annuity income. The Tax Court held that Beattie failed to prove the amount intended as a gift, and thus, the full annuity amount was taxable, up to 3% of the original consideration paid.

Facts

In 1927, Elizabeth Beattie and her husband, Edward Miller, transferred property worth $265,000 to Mount Union College in exchange for a "Survivorship Life Annuity Bond." The agreement stipulated that Miller would receive $18,000 annually during his lifetime, and upon his death, Beattie would receive $9,600 annually if she survived him. In 1933, the agreement was modified, reducing Miller's payments for a period. Miller died in 1936, and Beattie began receiving $6,000 annually. Beattie reported only a fraction of this amount as income, arguing that part of the original transfer was a gift to the college.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Beattie's 1941 income tax, arguing that a larger portion of the annuity income was taxable. Beattie petitioned the Tax Court, claiming an overpayment and seeking a refund. The Tax Court ruled in favor of the Commissioner.

Issue(s)

Whether the petitioner should pay income tax upon an annuity received, based upon the total value of property transferred in the acquisition thereof, or whether a part of such value should be considered a gift, thereby reducing the taxable portion of the annuity payments.

Holding

No, because the petitioner failed to provide sufficient evidence to establish the portion of the original transfer intended as a gift. The court found that the Commissioner's assessment was correct, taxing the full annuity amount received, up to 3% of the original consideration.

Court's Reasoning

The Tax Court relied on Section 22(b)(2) of the Internal Revenue Code, which dictates how annuities should be taxed. The court acknowledged Beattie's argument that the difference between the property transferred and the cost of a similar annuity from a commercial insurance company should be considered a gift. However, the court emphasized that the burden of proof rested on the taxpayer to demonstrate the element of gift and its amount. The court found Beattie's evidence insufficient to establish a specific amount intended as a gift. The court stated, "Therefore, we have here, as in *F. A. Gillespie*, 38 B. T. A. 673, a situation where the element of gift is not proven as to amount."

Further, the court rejected Beattie's attempt to value the annuity as of the date of her husband's death, stating that the annuity contract originated in 1927 and was only modified in 1933. The relevant date for determining the cost of a comparable annuity from an insurance company would be the date of the original agreement. The court also noted that the evidence regarding the cost of an annuity from John Hancock Life Insurance Co. was the only admissible evidence, and the evidence related to the rate as of April 1, 1936 was insufficient to establish the rate as of the date of Miller's death on March 26, 1936.

Practical Implications

This case highlights the importance of clear documentation when structuring charitable donations that involve annuities. To claim a portion of the transferred property as a gift and reduce the taxable annuity income, taxpayers must provide concrete evidence demonstrating the intent and amount of the gift. Vague or unsubstantiated claims will not suffice. This decision reinforces the principle that the cost of the annuity is determined at the time of the original agreement, not at a later date when the annuity payments begin. Later cases applying this ruling emphasize the taxpayer's burden of proof in establishing the gift element, particularly when dealing with annuity contracts from organizations that are not commercial insurance companies.

