T.C. Memo. 1950-153

When a taxpayer exchanges securities for annuity contracts from individual obligors, the taxable gain is limited to the amount by which the fair market value of the annuity contracts exceeds the taxpayer's basis in the securities, and if the fair market value is less than the basis, no taxable gain results.

Summary

The petitioner exchanged securities for annuity contracts from individual obligors. The court addressed whether the petitioner realized a taxable gain from this transaction in the taxable year. The court held that if the transaction is treated as a sale of securities, the petitioner's gain is limited to the amount by which the fair market value of the annuity contracts exceeded her basis in the securities. Because the fair market value of the annuities was less than the basis of the securities, no taxable gain resulted. The court also noted that if the transaction is considered a purchase of an annuity, the same conclusion would follow, as the petitioner received nothing from the contracts in the taxable year.

Facts

Petitioner transferred securities to individual obligors in exchange for annuity contracts. The terms of the annuity agreements were computed similarly to contracts from insurance companies, but the obligors were individuals, not insurance companies. The fair market value of the securities transferred was less than the petitioner's basis in those securities.
The petitioner was on the cash basis for tax purposes. The annuity contracts did not provide any cash income to the petitioner during the tax year at issue.

Procedural History

The Commissioner determined a deficiency in the petitioner's income tax. The petitioner appealed to the Tax Court, contesting the deficiency assessment.

Issue(s)

Whether the petitioner realized a taxable gain in the tax year when she exchanged securities for annuity contracts, where the fair market value of the annuities was less than the basis of the securities.

Holding

No, because the fair market value of the annuity contracts received was less than the petitioner's basis in the securities exchanged. Therefore, there was no gain to be recognized in the taxable year. If the transaction is viewed as a purchase of an annuity, the same conclusion applies as the petitioner received nothing from the contracts in the taxable year.

Court’s Reasoning

The court reasoned that if the transaction is treated as a sale of securities, as both parties assumed, the taxable gain is limited by Section 111(a) and (b) of the Internal Revenue Code to the excess of the fair market value of the annuity contracts over the petitioner’s basis in the securities. Since the fair market value was less than the basis, there was no taxable gain. The court noted that the obligors were individuals, not a “sound insurance company,” but that the annuity terms were similar to those of insurance companies.

The court referenced several cases, including *J. Darsie Lloyd, 33 B. T. A. 903; Frank C. Deering, 40 B. T. A. 984; Burnet v. Logan, 283 U. S. 404; Bedell v. Commissioner, 30 Fed. (2d) 622; Evans v. Rothensies, 114 Fed. (2d) 958; Cassatt v. Commissioner, 137 Fed. (2d) 745*, to support its conclusion that no taxable gain resulted under the circumstances. Alternatively, if the transaction were considered a purchase of an annuity, Section 22(b)(2) of the I.R.C. would preclude recognition of gain because the petitioner received nothing from the contracts in the taxable year.

Practical Implications

This case clarifies the tax treatment of annuity contracts received in exchange for property, particularly when the obligors are individuals rather than insurance companies. It highlights the importance of determining the fair market value of the annuity contracts and comparing it to the taxpayer’s basis in the exchanged property. Attorneys should advise clients that if the fair market value of the annuity is less than the basis of the property exchanged, no immediate taxable gain will be recognized. The ruling emphasizes that the substance of the transaction (sale of securities or purchase of annuity) does not alter the outcome if no cash or other property is received in the taxable year that exceeds the basis of the assets transferred. This case informs how similar transactions should be analyzed, emphasizing that the initial exchange may not trigger a taxable event if the value received does not exceed the taxpayer’s investment. Later cases may have further refined the valuation methods for such annuities or addressed situations where payments are received in subsequent years, triggering taxable income. This ruling is particularly relevant to estate planning and asset transfer strategies.

