***Parsons v. Commissioner of Internal Revenue*, 16 T.C. 256 (1951)**

For the purpose of determining taxable gain from the exchange of life insurance policies, the fair market value of a newly issued single premium life insurance policy is its cost at the time of issuance, not its cash surrender value.

Summary

Charles Parsons exchanged several endowment life insurance policies for new ordinary and limited payment life policies, plus a single premium life insurance policy. The Tax Court addressed the method for calculating taxable gain from this exchange, specifically focusing on the valuation of the single premium policy. Parsons argued the fair market value was the cash surrender value, while the Commissioner contended it was the policy's cost. The Tax Court sided with the Commissioner, holding that the fair market value of the single premium policy, for tax purposes, is its cost at issuance because that represents the price a willing buyer pays a willing seller in an arm's length transaction at the time of exchange.

Facts

Petitioner Charles Parsons owned several endowment life insurance policies issued by Northwestern Mutual Life Insurance Company.

In 1942, Parsons exercised an option to exchange these endowment policies for new ordinary and limited payment life policies.

As part of the exchange, Parsons also received a single premium life insurance policy with a face value of $8,500.

The total cash surrender value of the surrendered endowment policies was used to fund the new policies, including the single premium policy which cost $6,541.40 and had a cash surrender value of $5,531.02 on the date of issuance.

In calculating taxable gain from the exchange, Parsons used the cash surrender value of the new policies, while the Commissioner used the cost of the single premium policy.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Parsons' income tax for 1943 based on the method of calculating gain from the insurance policy exchange.

Parsons petitioned the United States Tax Court to contest the Commissioner's determination.

The Tax Court reviewed the Commissioner's method of computing taxable gain.

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Issue(s)

1. Whether, for the purpose of calculating taxable gain from the exchange of life insurance policies, the fair market value of a single premium life insurance policy received in the exchange is its cash surrender value or its cost at the time of issuance?

Holding

1. No, the fair market value of the single premium life insurance policy is its cost at the time of issuance, not its cash surrender value, because that cost represents the price agreed upon by a willing buyer and a willing seller at the time of the transaction.

Court's Reasoning

The court reasoned that a life insurance policy is considered property under tax statutes, and the exchange of policies constitutes a taxable exchange of property under Section 111(b) of the Internal Revenue Code.

The court considered Solicitor's Opinion 55, which provided guidance on calculating taxable gain from insurance policy exchanges, but found that Parsons misinterpreted it.

The central question was the determination of "fair market value" or "cash value" of the new policy. The court defined fair market value as "what a willing buyer would pay to a willing seller for an article where neither is acting under compulsion."

The court rejected Parsons' argument that cash surrender value represented fair market value, stating, "The cash surrender value of a life insurance policy is the amount that will be paid to the insured upon surrender of the policy for cancelation. It is merely the money which the company will pay to be released from its contract… For this reason, the cash surrender value is arbitrarily set at an amount considerably less than would be established by its reserve value."

The court emphasized that a single premium life insurance policy is unique property that appreciates over time and its fair market value at issuance is the price paid by the insured: "The fair market value of a single premium life insurance policy on the date of issuance is the price which the insured, as a willing buyer, paid the insurer, as a willing seller. If that is its fair market value in the hands of the insurer at the moment of issuance, what intervening factor is there to cause its value to decrease an instant later in the hands of the insured?"

The court concluded that the cost of the single premium policy, $6,514.40, was the appropriate measure of its fair market value for calculating taxable gain.

Practical Implications

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Parsons v. Commissioner establishes a clear rule for valuing single premium life insurance policies in taxable exchanges. It clarifies that for tax purposes, the fair market value is not the readily available cash surrender value, but rather the original cost of the policy. This decision is crucial for tax planning in situations involving exchanges of life insurance policies, especially when single premium policies are involved.

Legal professionals and taxpayers must use the cost basis, not the cash surrender value, when calculating taxable gains from such exchanges. This ruling impacts how accountants and tax advisors counsel clients on the tax implications of life insurance policy exchanges and ensures that the initial investment in a single premium policy is accurately reflected in tax calculations.

Later cases and IRS guidance have consistently followed the principle set forth in *Parsons*, reinforcing the cost basis as the proper measure of fair market value for single premium life insurance policies in similar contexts.

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