## *Johnson v. Commissioner*, 31 T.C. 361 (1958)

When an annuity is purchased in exchange for property, the tax basis for the annuity is the fair market value of the property exchanged, not the hypothetical cost of a similar annuity from a commercial insurance company.

### Summary

The case concerns the determination of the tax basis for an annuity received in exchange for shares of stock. The taxpayer received an annuity from a company in exchange for transferring stock she inherited. The IRS determined the annuity payments were taxable income. The taxpayer argued the basis for the annuity should be based on the cost of a similar annuity from a commercial insurance company, which was significantly higher than the value of the stock exchanged. The Tax Court held that the basis was the fair market value of the stock at the time of the exchange. This ruling underscores the principle that the actual consideration paid, rather than a hypothetical cost, determines the tax treatment of an annuity acquired through the exchange of property.

### Facts

The taxpayer inherited 117 shares of stock in E.H. Johnson Co. Upon her husband's death, the taxpayer, both individually and as executrix, transferred these shares to the company. In return, the company agreed to pay her an annuity of $8,000 per year for the rest of her life. The Commissioner of Internal Revenue included the $8,000 payments in the taxpayer's gross income for each of the years 1951-1954. The taxpayer contested this, arguing that the amounts received were a gift or bequest, or, if treated as an annuity, a portion should be excluded from gross income based on the rules for taxing annuities.

### Procedural History

The Commissioner determined deficiencies in the taxpayer's income tax. The taxpayer challenged the Commissioner's determination in the U.S. Tax Court. The Tax Court examined the tax treatment of the annuity payments, specifically focusing on the tax basis of the annuity. The Tax Court ultimately ruled in favor of the Commissioner in part, leading to this decision.

### Issue(s)

1. Whether the $8,000 annual payments received by the taxpayer were excludible from gross income as a gift or bequest.

2. If the payments are taxable as an annuity, what is the cost basis of the annuity for the purpose of calculating the taxable portion of the payments?

### Holding

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1. No, the payments were not excludible as a gift or bequest because the taxpayer transferred property (the stock) in exchange for the payments.

2. The cost basis of the annuity is the fair market value of the stock at the time of the transfer. The cost is not the amount a commercial insurance company would charge for a similar annuity.

**Court's Reasoning**

The court first dismissed the taxpayer's argument that the payments constituted a gift, noting that the transfer of the stock was the consideration for the annuity. The court then addressed the valuation issue for the annuity's basis, stating the annuity was acquired in exchange for property. The court found that the cost basis of the annuity was not the amount a commercial insurance company would have charged for an annuity. The court determined that the appropriate cost basis for the annuity was the fair market value of the 117 shares of stock that the taxpayer transferred to the company. The court cited Section 22(b)(2) of the 1939 Code (and similar provisions in the 1954 Code) and focused on what the taxpayer actually paid for the annuity. The court emphasized that the fair market value of the stock was the actual consideration paid, not a hypothetical cost determined by an insurance company. The court referenced Rev. Rul. 239, 1953-2 C.B. 53, to establish that the

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