Parsons v. Commissioner, 54 T. C. 54, 1970 U. S. Tax Ct. LEXIS 230 (T. C. 1970)

Exchanging stock with no cost basis for a life insurance policy results in taxable capital gain equal to the policy's value.

Summary

In Parsons v. Commissioner, the Tax Court ruled that the exchange of 50 shares of Lucey Export Corp. stock for a life insurance policy resulted in a long-term capital gain for the taxpayer, George W. Parsons. The court found that the stock had no cost basis, and thus the full value of the insurance policy, $6,130. 05, was taxable as capital gain. This case clarifies that even if an employer paid the premiums on the policy, the transfer of ownership to an employee in exchange for stock with zero basis triggers a taxable event. The decision underscores the importance of considering the tax implications of such exchanges and the necessity of establishing a cost basis for assets.

Facts

George W. Parsons was employed by Lucey Export Corp. since 1920 and received 50 shares of the company's stock in 1939 under a profit-sharing plan. The stock was deposited with a trust company, and the corporation purchased a life insurance policy on Parsons's life. In 1963, after the death of the company's president, Parsons exchanged his 50 shares of stock for the life insurance policy, which had a value of $6,130. 05. Parsons did not report this exchange as income on his 1963 tax return. The Commissioner determined that this exchange resulted in a long-term capital gain of $6,130. 05, as Parsons had no cost basis in the stock.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Parsons's 1963 income tax and issued a notice of deficiency. Parsons petitioned the Tax Court for a redetermination of the deficiency. The Tax Court held a trial and issued its opinion on January 21, 1970, ruling in favor of the Commissioner.

Issue(s)

1. Whether the exchange of 50 shares of Lucey Export Corp. stock for a life insurance policy resulted in a long-term capital gain for George W. Parsons?

Holding

1. Yes, because Parsons realized a long-term capital gain of $6,130. 05 upon exchanging his stock, which had no cost basis, for the life insurance policy.

Court's Reasoning

The court applied Section 1001 of the Internal Revenue Code, which governs the recognition of gain or loss on the sale or exchange of property. The court reasoned that the exchange of stock for the life insurance policy was a taxable event under this section. Since the stock had no cost basis, the full value of the life insurance policy, $6,130. 05, was taxable as a long-term capital gain. The court rejected Parsons's argument that the transfer should not result in a taxable transaction because the corporation had paid the premiums on the policy. The court also dismissed the applicability of Section 79, which deals with group-term life insurance, as the policy in question was an ordinary life policy owned by the corporation. The court emphasized that the burden of proof was on Parsons to show error in the Commissioner's determination, which he failed to do.

Practical Implications

This decision has significant implications for tax planning involving the exchange of stock for other assets. It highlights the importance of establishing a cost basis in stock, especially when received as part of employee compensation or profit-sharing plans. For legal practitioners, this case serves as a reminder to advise clients on the potential tax consequences of such exchanges and to ensure proper documentation of any basis in stock. Businesses must also consider the tax implications for employees when designing compensation packages that involve stock transfers. This ruling has been cited in subsequent cases to support the principle that the exchange of property with no cost basis results in taxable gain equal to the value of the received property.